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REVENUE AND SPENDING PROPOSALS FOR FISCAL YEAR 1990

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

MARCH 9, 1989

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REVENUE AND SPENDING PROPOSALS FOR FISCAL YEAR 1990

THURSDAY, MARCH 9, 1989

U.S. Senate,
Committee on Finance,
Washington, DC

The hearing was convened, pursuant to notice, at 9:35 a.m. in room SD-215, Dirksen Senate Office Building, the Hon. Lloyd Bentsen (chairman of the committee) presiding.

Also present: Senators Moynihan, Baucus, Rockefeller, Packwood, Roth, Chafee, Heinz, and Durenberger.

[The prepared statements of Senators Chafee, Durenberger, Heinz, Moynihan, and Rockefeller appear in the appendix.]

[The press release announcing the hearing follows:]

[Press Release No. H-10, February 28, 1989]

BENTSEN ANNOUNCES FINANCE COMMITTEE HEARINGS ON REVENUE AND SPENDING PROPOSALS IN THE 1990 BUDGET

WASHINGTON, DC—Senator Lloyd Bentsen (D., Texas), Chairman, announced Tuesday that the Committee on Finance will hold a series of hearings on revenue and spending proposals contained in President Bush's budget for fiscal year 1990.

The hearings are scheduled for *Thursday, March 9; Tuesday March 14; Wednesday March 15; and Thursday March 16, 1989 at 10:00 a.m.* in room SD-215 of the Dirksen Office Building.

Bentsen said the March 9 hearing will examine the underlying economic assumptions contained in President Bush's budget; the hearing on March 14 will consider the President's proposal to lower the tax rate on capital gains from the current 33 percent to 15 percent; in the March 15 hearing, the Committee will hear from the Treasury Department about their other revenue proposals as well as expiring tax provisions not included in the Bush budget; and on March 16, the hearing will analyze proposed spending cuts contained in the 1990 budget.

"I want to give the President's budget a fair hearing. Some attractive ideas have been outlined, but at the same time, legitimate concerns have been raised about some aspects of the budget. The Committee will closely examine the President's proposals for outlay and revenue changes, as well as the economic assumptions which underlie the Administration's deficit projections," Bentsen said.

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS, CHAIRMAN, SENATE FINANCE COMMITTEE

The CHAIRMAN. I am afraid we have a long day ahead of us and some very serious and important questions to try to understand better, both between the Executive Branch and the Legislative Branch.

I am going to ask the help of my colleagues on the Committee by, if we may, limiting the opening statements to that of the Chairman and the Ranking Member. We will take the statements that the other Members would have liked to have made in their entirety in the record and ask unanimous consent to distribute them to the press.

With that in mind, let's proceed. Everyone understands that we have to get this budget deficit under control. That means helping reduce the cost of money so that we can better compete internationally on trade.

But as we look at it, I don't see how we can make real headway unless we get at least close to an agreement on how we treat some of the basics, such as health care for Americans, and that we get an accurate starting point on the economic assumptions for this budget.

The President, in his budget, would reduce Medicare by approximately $5 billion. Mr. Darman, as far as I am concerned, that is absolutely unacceptable. I went through that fight at the end of 1987, and I saw it almost start up again at the beginning of 1988.

Medicare would be a lot better off under a sequester. Should that happen, means-tested programs and Social Security would be protected, and Medicare would lose about $2 billion, or 2 percent.

Given a choice between the Medicare cuts, as submitted in the Administration's budget proposal and a sequester, I would much prefer the latter.

Well, we have a third and I think a much more preferable choice, and that is for the Administration and this Congress to work together to develop a mutually agreeable plan.

It sure is obvious that a lot more work has to be done on the spending proposals that the President has made, particularly as they affect the health care system and they affect children. That is because I think the President's budget really ignores the clear evidence that many of the nation's hospitals are in real trouble. That is particularly true for the rural areas with the number of rural hospitals that are closing across the country.

I certainly see that in my own State, where we had, as I recall, 19 of them close last year. These closings can do irreparable damage to the nation's health care system.

It is a simple fact that Medicare, the Nation's single largest health insurer, is failing to cover the cost of treating the elderly and disabled Americans in half of the Nation's hospitals.

In addition, the President's budget reduces Medicare by more than $5 billion, while making no proposal for real structural reforms that I think have to be made to keep this from just being a recurring problem. I think that is particularly true of Part B, which is expected to grow more than three times the rate of inflation next year.

You have to have some kind of a structural adjustment in that one, I believe.

What is more, if the economic forecast proves accurate, the President's budget hits the Gramm-Rudman targets by taking only the most tentative steps toward addressing the Nation's failure to invest in the health of our children.

The President's statements in support of enhancing Medicaid and other child health care programs I think are commendable, but his budget document emphasizes Medicaid expansions that have already been enacted into law, already approved by the Congress, paid for in the last Congress. Moreover, the President's new proposal would assure Medicaid access for fewer than one out of every 10 infants who currently don't have health insurance. We have just got to find a way to do better than that.

As we examine these proposed cuts in Medicare, we are also going to be looking at some of those economic assumptions that make up this budget.

The President's budget calls for a deficit of $95 billion. But we have other forecasts, and quite a number of them are not nearly so optimistic.

Late this morning, we will be hearing from the Congressional Budget Office. They have taken a look at the administration's budget proposal, and I understand that they came up with numbers quite different from those of the administration for the forthcoming year, and dramatically different for the following four years.

I agree, and I am sure you will say, Mr. Darman, that projections are just that; they aren't foolproof. But you have to start at some point, and you have to be as honest and as realistic as you can be with the assumptions so that your projections are achievable.

Eight years ago we had another Director of the Office of Management and Budget who came before us and told us, with the administration's assumptions and projections we were going to have a balanced budget by 1984. Not only did that not happen, but we saw our budget deficits in the last eight years total more than the deficits of all the Presidents from George Washington to Jimmy Carter.

So it is important that we get these projections on as sound of a foundation as we can.

Over the next 5 years, the President's budget assumes a simultaneous real GNP growth exceeding 3.2 percent and a spontaneous increase in productivity. As I recall, in the last year, we have had an increase in productivity of about seven-tenths of 1 percent.

It also assumes that unemployment is going to drop to the lowest level that it has been since 1973, that inflation will fall to levels not seen since 1965, interest rates to levels not reached since 1962. Now, what do we have here, an album of the "greatest hits?" Or the "golden oldies?" Or U.S. economic highlights? Or a responsible basis for budgeting?

Let me say, first, that I hope all of those rosy projections come about; but I sure wouldn't bet on it. We need to get to the bottom of those assumptions and proposals and get a more complete picture of what this budget would do and what changes are needed in it. And it is essential we work together and try to achieve that goal, and that we do our darnedest to try to avoid that sequester if we can.

I now defer to the Senior Senator from the State of Oregon, the ranking member.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON

Senator Packwood. Mr. Chairman, thank you.

Among other things, I would appreciate it if the witnesses would address themselves to the question of how, if we were to have a tax increase, it reduces the deficit, because I do not follow the logic.

As I understand the law at the moment, we must limit the deficit next year to $110 billion, which would be the Gramm-Rudman total of $100 billion plus the $10 billion fudge factor. If all else fails, if we do not reach an agreement then we are going to have a deficit of $100 billion—because of sequestration. But I have heard Mr. Darman say on more than one occasion that the President will follow the law. He doesn't have any judgment or discretion on it; the law is Gramm-Rudman and the sequester.

So what I am presuming that people mean when they say, "Let's have a tax increase to reduce the deficit," is that, based upon OMB's mid-summer deficit snapshot, we are not going to meet the $110 billion target. Instead, the projected deficit is going to be $130 or $140 billion, and they are talking about a $20 or $30 billion tax increase to get down to the $110 billion deficit total, which is actually $10 billion higher than the total we would get to with a sequester.

I think what they are saying is that they want the $20 or $30 billion of additional revenue to continue to sustain programs that would otherwise be cut or restrained by the sequester. And that is a fair debate.

The Chairman has mentioned any number of programs that he thinks the administration treats less than generously. It is a fair debate as to whether you want to use a tax increase to support spending levels at current or slightly increased spending levels, or whether you want no tax increase and a budget or a sequester that reaches a $100-110 billion total.

But it seems to me that the only that you could say a tax increase will reduce the deficit is if you were to reduce the Gramm-Rudman targets at the same time. If you want a $20 billion increase to reduce the deficit, then lower the $100 billion Gramm-Rudman target to $80 billion, and that will force you to use the tax increase to reduce the deficit. I don't see how we get there otherwise.

Second, as to the economic projections, I looked at the General Accounting Office report in 1986, which basically says this: On balance, nobody has a leg up on economic forecasts—not OMB, not CBO, certainly not the private forecasters—that on balance OMB has been slightly more accurate on predicting inflation and interest rates, on balance CBO has been slightly more accurate in predicting growth rates; but if you add them all together their margins of errors are relatively slight.

I would like the witnesses to address themselves as to why it is we think the growth rate is going to be so extraordinarily low. If I understand the figures correctly, we have had 3.25 percent average real growth over the last 40 years, including eight recessions. In the last 6 years we have had about a 4 percent real growth. I am curious, therefore, what has caused some people to come to the projection of 2.6 percent growth, lower than the average, dramatically lower than the last six years—maybe accurate; no one knows ahead of time if they are accurate. But I am curious why the dramatic fall in the projections.

Lastly, I heard the Chairman talk about the other Budget Director, and I am sure he means Mr. Stockman and the projections as to what the deficits and surpluses were going to be.

I think it is fair to look back upon what we all thought the deficits were going to be for the surpluses in 1980 and 1981, because Congress was a partner in that tax cut, and I know there have been criticisms of the tax cut. So I just want to go back and take a look at a series of projections starting in January of 1980. This was the Carter OMB. In January of 1980 they were predicting a surplus, by 1985, of $158 billion. In February 1980, CBO's baseline projection for the 1985 surplus was $178 billion.

Now we come to 1981, the last Carter OMB projection, in January. They had lowered their projections a bit, but they were showing a $138 billion surplus by 1986.

And then, most interestingly, the last reports we had to go on prior to our enacting the tax cut in August—and this was the congressional Budget Office projection—in July 1981 the congressional budget Office predicted, on a baseline—this was not including the Reagan spending cuts or the Reagan tax cut—the CBO baseline projected a $209 billion surplus by 1986. With the Reagan spending cuts and tax cuts, the congressional budget resolution was predicting a balance in 1984.

What no one projected were two things: One, the dramatic drop in inflation—CBO didn't catch it, OMB didn't catch it, the private forecasters didn't catch it—and of course, in 1981 we had not yet indexed the Tax Code. So if you projected high inflation, you were going to have dramatically higher revenue increases.

Second, no one projected, with one private forecaster exception, no one in the summer of 1981 projected the recession. And in a recession, your revenues fall.

So, in my judgment, very clearly what we did in the summer of 1981 was to cut taxes so that we would reduce the surplus, so that we wouldn't spend the surplus. And it was only after we had enacted the tax cuts that we had the dramatic increases in the deficits, because we did not project the fall of the inflation, and we did not project the recession.

But the error in projection was not Mr. Stockman's or OMB's alone, it was CBO's, and with one exception it was all private forecasters.

Therefore, I think as we look ahead we should remember that we have all made extraordinary mistakes in the past on projections, and we should not necessarily hit upon OMB or CBO, or Wharton, or Chase, or anybody else, as "the guru" of projections and say, "That is going to be the exact way the economy is going to behave in the future."

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Darman?

STATEMENT OF HON. RICHARD DARMAN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. DARMAN. Thank you very much, Mr. Chairman.

May I ask that my statement be included in the record in its entirety, along with appendices, and that I make an abbreviated version of that statement in order to economize on your time?

The CHAIRMAN. Do we have that abbreviated version before us?

Mr. DARMAN. I don't think you do.

The CHAIRMAN. Well, we will take it in its entirety. It would be helpful, you know, to enable us to follow you, if we could get the abbreviated version in the future.

Mr. DARMAN. I don't have copies, but what I can do is quickly refer you to the places in the text where it will be relevant.

The CHAIRMAN. All right. If we have a problem, we will interrupt and ask you.

Mr. DARMAN. Chairman Bentsen, Senator Packwood, distinguished Members of the Senate Finance Committee, please let me thank you very much for this opportunity to discuss President Bush's budget proposals.

If I could pause for just one moment, in the same spirit of recalling "oldies but goodies," I might say that it is, for me at least, a special pleasure to come back here, because my last recollection is not of 1981 but rather of some extraordinary days, especially in May 1986, where right in this room at midnight or sometime thereafter, as I recall in about the third week of May, we had a 20-to-nothing vote in favor of tax reform, something that not too many weeks and months before people said could never be done. So, I have a rather favorable view of some of the history that involves this committee, as I know you do, too.

I appear before you today in what I hope you will find to be a constructive spirit, seeking to advance our common objective: the prompt enactment of a responsible budget program that can meet the Gramm-Rudman-Hollings deficit reduction targets on schedule.

With your permission, I would first outline the President's overall approach to the budget, and then note the very important set of proposals that directly involve the Senate Finance committee before responding to your questions.

In seeking to meet the Gramm-Rudman-Hollings objective on time, the President has suggested that a responsible set of budget proposals must pass several basic tests:

They must attend to fundamental obligations, such as the payment of interest, the protection of national security, and the funding of Social Security.

Within the limits of scarce resources, they must address special obligations—to the poor, as through means-tested entitlement programs and incentives for child care, and to future generations as through environmental protection.

They must begin to remedy problems inherited from the past—the scourge of drugs, the crisis in the savings and loan sector, the failure to invest adequately in the modernization and clean-up of nuclear weapons production.

And they must advance priorities for future American growth and competitiveness, as through measures to encourage sound investment in research, education, enterprise, and longer-term productivity.

They must do all these things while also restoring fiscal balance, meeting the Gramm-Rudman-Hollings targets without raising taxes and without threatening what is now America's longest period of sustained peacetime economic growth.

The President's proposals were presented to the Congress, as you know, on February 9 in a 193-page volume entitled "Building a Better America." His proposals meet the several tests I have noted.

In addition to the 193-page volume, we have since provided the Congress with over 4,000 pages of supplementary detail. These submissions are noted at Appendix A and are contrasted with submissions of prior Presidents.

With these various submissions and through informal consultation as well, I think it fair to say that we have submitted more data in explanation than any new President has done at a comparable stage of his presidency in the modern budgeting era.

Mr. Chairman, I would now propose to skip the next section, which is entitled "Changing a Habit of Mind: from Wonderland Budgeting to Common Sense Budgeting."

I think you are by now well aware that we have launched a critique of current services budgeting, and since you are well familiar with the argument, I will spare you the burden of hearing it one more time. I might, however, ask that I be able to return to it when we get to a discussion of Medicare.

The CHAIRMAN. Of course.

Mr. DARMAN. Moving then to the section entitled "Shifting Perspective," whatever one's views on the Wonderland budgeters' habit of mind, in thinking in terms of current services, there is another issue of perspective that is, I think, even more important. Whether we budget from last year's levels, a zero base, current services, or any other reference point, it is essential that we give greater attention to investment in the future. As a matter of analysis, that means we must attend to the relative emphasis given to new spending for current transfers and consumption versus new spending for future gains in productive power and the quality of life.

Our freedom for spending initiatives is limited. We are constrained by problems from the past and obligations to the present. But within the limits set by these constraints, President Bush's proposed initiatives tilt toward the future.

They emphasize—and I will just tick off the major headings: Investment in research and development, investment in education and child development, investment in the protection of the environment, investment in combating drug abuse, and investment in the creation of incentives for new economic opportunity.

The list of seemingly worthy claims always exceeds available resources. It is limited only by human imagination. The necessity for choice is inescapable. For a summary of President Bush's priority choices, I would refer you to Appendices B and C. But in making choices, it is important to note: the voters of the present are well represented; the citizens of the future are less so. At the margin of choice, the citizens of the future must depend upon the wisdom and generosity of a present generation that is willing to invest in the future.

But the question is rightly asked, how do we finance all of this? The answer, I would contend, is straightforward. The first and most important contributor is economic growth. With a growing economy and no change in current law, revenues are projected to increase from $978.6 billion in fiscal year 1989 to $1.06 trillion in fiscal year 1990; that is an increase of more than $80 billion. The congressional Budget Office estimates even higher revenues than the administration. That is, in any case, no small amount of money. It is more than the GNP of 137 countries.

Even so, with the claims made by deficit reduction, by fundamental and special obligations, the need to address problems from the past, and priorities for initiative and investment, there is also a need for restraint on the growth of the remainder of the budget. This need is mitigated somewhat by certain mandatory programs that naturally decline. These are summarized at Appendix D. It is mitigated further by our ability to make sensible reforms in programs that would otherwise be an excessive drain on limited resources. Our proposals here are summarized at Appendix E.

Still, in order to meet the Gramm-Rudman-Hollings targets, there remains a need to freeze the remainder of the budget as follows: freeze all retirement COLA's for Federal civilian and military employees for one year, freeze defense budget authority at zero real growth for one year, and freeze residual non-defense spending, other than in areas of priority initiatives, at 1989 levels for one year. The effects of this set of freezes are summarized at Appendix F.

With these steps, it is possible to fund necessary and desirable program growth while also reducing the budget deficit below the target of $100 billion in fiscal year 1990.

I would note that using the CBO technical and economic assumptions, which as you have suggested, Mr. Chairman, will be made public today, and the administration's treatment of the financing of the savings and loan fix-up, the Bush proposals would still produce a deficit estimated to be below the Gramm-Rudman-Hollings sequester trigger point. I am sure that is a point we will wish to come back to.

The net effect of all of President Bush's proposals would be to increase total spending by 1.2 percent. Within this total, defense outlays, including atomic weapons production and clean-up, would increase by only 0.7 percent. All non-defense discretionary program outlays would increase by 3.3 percent, and all other mandatory programs, including those that naturally decline, would increase by 1.1 percent. Since revenues are projected to increase by about 9 percent, the deficit can be reduced substantially even as all these major expenditure areas grow.

That said, I must emphasize that our exact economic and deficit projections are not what I would forecast. And here, Mr. Chairman, I would take the liberty of commenting on your reference to Mr. Stockman. He is a friend, and I mean no disrespect in saying this, but there is a significant difference between us, I believe. I think that he was considerably more confident; at least, he expressed a much higher degree of confidence in the validity of his projections than you will find me doing. As these additional comments and answers to your questions will suggest. I am much more inclined to treat this as an area of uncertainty.

In any case, as I have said, the deficit projections are not exactly what I would forecast. They are dependent on a host of variables and conditions that are not wholly within our control or within economists' ability to forecast reliably.

One of the key conditions is political, not economic. Our projections depend upon prompt congressional enactment of the President's program, or something close to it. Clearly, if there is not prompt and responsible legislative action to reduce the deficit, there will be greater market risks, and it will be substantially less likely that our conditional projections may be achieved in the manner intended. We would have to rely upon sequester, a clumsy way to proceed although a necessary back-up discipline.

As for economic assumptions, these are, of course, endlessly arguable. But here I would make three general points:

First, although micro-economics has much to recommend it, macro-economics is not really well enough developed to justify its claim to the label "science." It is highly fallible.

In the period 1981 to 1998, for example, the administration, CBO, and the "Blue Chip" group of forecasters all had large mean errors in their forecasts of nominal GNP for one year ahead. As Senator Packwood has suggested, they were all close to each other, but the size of their errors was all rather large—2.6, 2.4, and 2.6 percent, respectively. It is a regrettable fact of macro-economic forecasting that forecasts are often closer to each other than they are to being correct.

Second, the administration's assumptions are perhaps most vulnerable with regard to out-year interest rates. It is at least noteworthy, however, that it is possible for others to be wrong in addition to the administration.

In 1982, for example, CBO forecast 1983 T bill rates at 13.2 percent. Blue Chip forecast 10.7 percent, and realty came in at 8.6 percent. In 1985, one saw the same pattern. Blue Chip forecast 9 percent for 1986, CBO forecast 8.7 percent, and realty came in at 6 percent.

I am not trying to suggest that the administration is right and others are wrong; rather, I mean to suggest simply that we should not have too much faith in any macro-economic forecasts. In the end it is probably not a bad idea to rely upon common sense.

If the administration is wrong about interest rates, it is probably also wrong about inflation. And the combination of these errors would produce much less adverse effect on the deficit, all other things being equal, than would an interest rate error alone.

The Chairman of the Federal Reserve has said that if a program deficit reduction such as the President's were enacted, he would expect interest rates to come down substantially. For a host of reasons, this seems desirable. And to me it seems common-sensical that if we wish to see interest rates come down in the current context, we should move forward with responsible deficit reduction.

Third, the administration's long-term sustainable real growth projection, averaging about 3.25 percent, has been challenged by some who believe it should or must be lower. CBO, as I am sure you will note in their estimate, assumes it will be more like 2.5 percent. But from 1948 to the present, a period that includes eight recessions, real growth in the American economy has averaged 3.25 percent--exactly the trend line that ours is on.

I see no reason to settle for a lower long-term projection than we have been able to achieve over the past 40 years. To do so would be unnecessarily defeatist.

The argument, it seems to me, ought not to be about whether or not we should lower the future trend line. Rather, it should be about what set of policies are most likely to assure that we are capable of sustaining our historical pattern of growth.

For our part, we believe that policies such as the President's—that would lower the deficit, increase savings and investment, increase R&D, increase investment in human capital, and ultimately increase productivity—that these are the key to sustaining growth.

In implementing the President's approach to the budget, or any other serious approach, the Senate Finance committee quite obviously has a fundamentally important role. The committee must address proposals in three broad areas: special entitlement obligations, receipts, and structural reforms of existing programs.

Since these are well-known to the committee, may I suggest that I simply note that they are summarized and available in the text that you have, but suggest that we move quickly over that list of programs which are also summarized in appendices and move to the concluding section that is entitled "The Need to Negotiate".

So, in concluding this overview, Mr. Chairman, I should emphasize that we do not pretend to have either all the answers or the only acceptable set of answers. We have offered a set of proposals that we believe have merit. We look forward to learning of other proposals and to discussing them on the merits. We mean to be cooperative. But this, of course, is not enough. We cannot unilaterally produce a budget. We in the executive branch cannot legislate. We can offer and exchange views, but in the end we must come to an executive-legislative agreement. To that end, as a matter of practical reality, we must negotiate.

I would note, Mr. Chairman, that since this text was prepared and delivered, last evening, we were informed by Chairman Panetta and Chairman Sasser, the Democratic chairmen of the Budget Committees, have agreed to and propose that we actually formalize a process of negotiation, and we will be meeting with them this afternoon to discuss that further. So, these printed remarks in the text may have been overtaken by events. If so, we are of course delighted, because although the real economy remains strong, interest rates are rising, and markets seem less firm than one would wish.

Our Government is divided between the two great parties. That division is viewed by some as a formula for stalemate, and stalemate is fraught with risks. The risks are economic: if we do not act responsibly and in a timely fashion, rising interest rates may cause the economy to flounder, creating significant human costs in the process. And the risks are political: if we do not act responsibly and in a timely fashion, public cynicism about our collective capacity to govern may only deepen.

But it need not be so. The President has said that this is not the time to settle for business as usual. Our job, as we see it, is to do our utmost to make divided government work. We are prepared to work in good faith, in a bipartisan spirit, day and night if that is what it takes to reach a constructive agreement on time.

So in that spirit, I would be pleased to try to respond to your questions. And may I thank you again for inviting me to appear before you today.

The **Chairman**. Thank you, Mr. Darman.

[Mr. Darman's prepared statement appears in the appendix.]

The **Chairman**. We will observe the early-arrival rule, and they will be in this sequence: Senator Moynihan, Senator Packwood, Senator Rockefeller, Senator Durenberger, Senator Chafee, Senator Baucus and any others—oh, and Senator Roth.

Well, I appreciate your candor about the fact, as we have agreed, that these are just projections. But a matter of concern to me is where we are today on some of these numbers, and what these economic assumptions happen to be.

As I look through them—and let us run the questioning to 7 minutes, to try to get a little more time for follow-up on this—the administration says that GNP is going to grow 3.3 percent in 1989. But in the fourth quarter it grew at an annual rate of only 2 percent.

The administration says short-term interest rates will be 7.4 percent in 1989; but 3-month Treasury bills now are paying 8.65 percent. It says inflation will be at 3.6 percent in 1989, but inflation increased at an annual rate of 7.2 percent in January.

Now, you have only got 9 months left, and all of these statistics, all of these numbers, are running the other way. I don't see how you can realistically feel that you are going to be able to turn this around that fast. And what concerns me is when we get to August and you revise these economic assumptions. We would have spent all of this time, and we would then have to do something rather draconian, beyond what we had already done.

Now, you referred to your good friend David Stockman, and I noted what he said about the Reagan budget's economic assumptions, which aren't that different from this ones. He stated, "They are entirely fictional and out of this world."

Another one that concerns me is, predictably, on the question of productivity, because that materially affects these assumptions, particularly in the out-years.

In a period of strong economic growth, between 1981 and 1988, productivity increased only an average of 1.4 percent. Between the fourth quarters of 1987 and 1988, it increased, as I noted earlier, by seven-tenths of 1 percent. Now, you are talking about productivity rates of 2 percent, and I sure hope you are right. But I don't see where it is coming from. Can you tell me on what basis you are making those predictions, particularly on the question of increases in productivity?

Mr. **Darman**. Yes, sir. May I comment on the prior points as well?

The **Chairman**. Of course.

Mr. **Darman**. On GNP and our interest rate assumptions in relation to where they are in the market at the moment, we made, as you know, two sets of changes in the Reagan assumptions. With respect to interest rates, we did adjust for the market as it is, and the problem that one could focus on is: Is the slope that we have of interest rates coming down, is that too steep a slope to be viewed as realistic?

The **Chairman**. That's right.

Mr. **Darman**. But we have made the adjustment for interest rates as they are in the marketplace.

Then, as you know, the drought had an effect on the fourth quarter GNP, and GNP has been coming in higher than we and CBO forecast, including the fourth quarter. We only made half of that adjustment. And if we were to adjust further for where GNP is in fact, as opposed to where we forecast, the deficit would be a little bit lower. It might be about $3 billion lower than we forecast, and that is a continuing favorable effect, all other things being equal. We haven't yet made that adjustment fully. It is a small point.

I would grant your point, however—what I take to be your point—which is that, even though we have made these adjustments, the slope downward of the interest rates may be too steep in our forecasts.

The **Chairman**. I, frankly, feel so. You say a lot of this is a gut reaction, that we do not have an exact science here. But I truly feel that is seriously over-optimistic.

Mr. **Darman**. Our forecast, just to give you the quarterly break—it looks like a big break when you look at the annual averages, but the quarterly one goes: in 1989, first quarter, 8.3 percent, which is the market, to 7.7—these are succeeding quarters—7.7, 7.1, 6.5, 6.0. That then gets us back on what the Reagan economic forecast line was. That is not an extraordinary steep slope, if we get a significant budget-reduction agreement.

The **Chairman**. And, that it is credible.

Mr. **Darman**. And that is credible, and timely. And those are very important conditions.

We would still probably have an argument about the out-year forecasts, because, again, there is a long-term trend, way down, back to rates from a couple of decades before in both inflation and interest rates. But there, I would just make this point—I will repeat a point I made in the testimony, if you assume that we are wrong on interest rates for the out-years, it is probably because we are wrong on the inflation number in the out-years.

The **Chairman**. And you would say that with inflation going up, you would collect more revenue?

Mr. **Darman**. Yes, and CBO would, too.

Mr. Chairman. Do you think those things are a wash?

Mr. **Darman**. No, not exactly, but they are quite close. I can tell you how it comes out on our model: If we were to assume across the board that interest rates increased by 1 percent, and inflation increased by 1 percent as well, all the way through 1994, it would reduce the deficit by about a billion in 1989, it would increase it by 1.8 in 1990, 2.1 in 1991, 2.0 in 1992, 1.4 in 1993, and then decrease it by 0.3 in 1994. Now, that is a very different pattern than if you just move the interest rates. If you only move the interest rates, those numbers are much larger—they go 2.8, 8.1, 11.5, 13.8, 15.4, 16.4.

The **Chairman**. Because of the time limitation, let me say what concerns me if we don't use realistic assumptions. If you come up with OMB estimates that are overly optimistic, and we marginally meet the Gramm-Rudman target using the same assumptions, as you have done, we may find we are way off that mark as reality finally comes about. What concerns me is that we will be managing crises for the next four years on both sides, and we will keep interest rates high in this country, and we will have a terrible time being internationally competitive.

Let me get to the point of the question.

Mr. DARMAN. Productivity.

The CHAIRMAN. What?

Mr. DARMAN. I didn't answer your question on productivity.

The CHAIRMAN. I have more questions yet coming.

Mr. DARMAN. Okay.

The CHAIRMAN. Well, let me have it on productivity. You will use up the time on it, but let's go.

Mr. DARMAN. Well, I can try to be brief. Our productivity assumption is not quite 2 percent; it averages 1.9 percent. Of course, in earlier periods we have been as high as 3 percent or more, as an average; but 1.9 percent is back on our trend line.

The question is, why should we be getting back on that trend line? It is not extraordinary. And the principal piece of the answer, I think, is in the aging of the baby boom generation in the labor force. You had a large number of entrants who were baby-boomers, women, and minorities, who are now largely absorbed in the labor force and are no longer as unproductive—that is not quite the right term—as low-productive as new entrants; they are now much more experienced, and one has more productivity just from the demographics.

That isn't the only reason, but it is an important reason why we should expect productivity to increase.

The CHAIRMAN. We are going to be having a second round. I can see that, Mr. Darman.

Senator Packwood?

Senator PACKWOOD. Mr. Darman, I want to ask you a question bout Mr. Reischauer's statement, just to make sure that you and he agree, and I will read you what he says. Actually, it is an estimate.

In his statement, he says that the administration estimate for the deficit in 1990, including asset sales, is $91 billion. Is that correct?

Mr. DARMAN. Right.

Senator PACKWOOD. And the asset sales are about $3 billion.

Mr. DARMAN. Right.

Senator PACKWOOD. So, without them, $94 billion.

Mr. DARMAN. A little more, yes, 94.8. Right.

Senator PACKWOOD. And this does not include the S&L's; we will get to that in a minute.

Then, CBO's estimate of the Bush budget, excluding the asset sales which is the $3 billion, and the S&L's, is $109 billion. That is what they say their estimate is. Do you agree with that, that is their estimate?

Mr. DARMAN. Yes, if you use their economic assumptions, their technical assumptions, and you only adjust for asset sales and S&L's, then the answer is 109.

Senator PACKWOOD. It is only a difference of $15 billion in a federal budget of $1 trillion 160 billion. And they say their differences are based upon economic differences and technical differences—the economic differences being $9 billion and the technical differences being $8 billion.

Mr. Darman. Right.

Senator Packwood. So what they are saying is, if the President's budget is enacted, then they estimate a $109 billion deficit not counting the asset sales. You are saying if the President's budget is enacted, you are estimating a $94 billion deficit not counting the asset sales.

So, to begin with, we are not that far off in terms of the estimates for fiscal year 1990.

Mr. Darman. Remarkably close.

Senator Packwood. It is remarkably close in a budget of, as I say, $1 trillion 160 billion. To be off between CBO and OMB only $15 billion is not a dramatic difference.

If we have to sequester, we have to sequester to $100 billion, not $110 billion. Is that correct?

Mr. Darman. Correct.

Senator Packwood. And the 110 is only if we happen to come in with a deficit projection in the summer slightly less than 110 or up to 110. We don't have to sequester. We only have to sequester over that $10 billion range.

Mr. Darman. Correct.

Senator Packwood. Okay.

Now, in terms of the arguments about a tax increase to narrow the deficit, have you heard of anybody talking about a tax increase specifically for that purpose, and therefore coupling it with a lowering of the reduction of the Gramm-Rudman-Hollings target?

Mr. Darman. Not publicly, with the possible exception of Senator Hollings, who I think may have. I am not sure how he proposes to use his value-added tax. I think it involves a significant debt buy-down and would move beyond the Gramm-Rudman targets.

Senator Packwood. And in fairness to Senator Hollings, that is a position he has held for a number of years, as a matter of fact, as to how we would get to a balanced budget in a relatively short period of time.

But almost everybody else who asks for a tax increase, as best I can tell, is asking for a tax increase in order to make spending restraint unnecessary.

Mr. Darman. Correct.

Senator Packwood. In most cases it is not. And I think your definition of a cut is a good definition. If you were to talk to the average citizen and ask them what they mean by "cut," they mean "less than last year." They don't mean less than what might have been next year. To anybody who has a salary, and they are making $100 a week, and if they make $100 a week next year, they don't think they have been "cut." They wish they had gotten an increase, but they don't think they have been "cut."

I think those who want a tax increase are hard-pressed to really say it is to reduce the deficit—short of an opinion like Senator Hollings', where he indeed changes the targets.

Now, let me ask you a third question, if I might. This relates to the 3.2 percent projection on growth. Would you run by me the assumptions, once more? Because, frankly, I have to admit I am hard-pressed to understand why, if we have been growing at 4 percent, and if our historical average is 3.25 percent for 40 years including eight recessions, why suddenly the projection should be so dramatically lower, not just in the 4 percent but lower in the historical average with good years and bad years thrown together. So, run by me the assumptions once more of the 3.25 growth.

Mr. **Darman**. Well, we are on, as I have said, the historic trend line, and I think the question should be why does CBO forecast much lower growth. I think that the answers would be twofold: One is short term, and one long.

On short term, they don't like to forecast a recession. But I think that they are assuming that monetary policy will continue to be quite tight and will restrain growth very substantially. And we differ on that—not as to whether monetary policy will be tight, but whether monetary policy would cause interest rates to continue to rise, because we are assuming a substantial change when a budget agreement is reached.

The more interesting question is the long-term question, in my opinion. There, they assume that the long-term sustainable growth rate is only 2.5 percent; and we assume, as you have said, 3.25 percent. That number has only two components. One is growth in the labor force, and the other is growth in productivity.

We are pretty close on labor force. The difference is on the productivity assumption: ours is 1.9 percent and theirs is 1.4. That is a highly judgmental matter. For 1.9 to be right, you have to be back on the long-term trend line. I suggest that the natural demographic effect of a labor force that is now aging has a favorable effect on productivity. That is agreed, generally; the question is how much.

And then, in addition, the question is: How much favorable effect on productivity do you have from proposals and policies that increase the savings rate and increase investment? That, too, is arguable. But you need only a very small change in the productivity assumption, and you will have a higher long-term, sustainable real growth rate.

Senator **Packwood**. I have no more questions right now, Mr. Chairman.

The **Chairman**. Thank you.

Senator Rockefeller?

Thank you, Mr. Chairman.

OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER, IV, A U.S. SENATOR FROM WEST VIRGINIA

Senator **Rockefeller**. Mr. Darman, good morning. We had a hearing on Medicare this past week, and a number of witnesses testified that out-of-pocket health care costs for Medicare beneficiaries rose by 49 percent, while at the same time average incomes per capita grew by only 18.5 percent.

The elderly are seeing more and more of their fixed incomes obviously, therefore, being spent on health care. Last year we passed catastrophic legislation. We were told by the President that catastrophic coverage would have to be paid for by beneficiaries, and indeed it was, and indeed we are hearing about it.

Two years ago, beneficiaries saw a 38 percent increase in their Medicare Part B premium. Now some seniors, as I indicated, are going to be seeing a large increase in their part B premium because of catastrophic legislation.

I am worried and would welcome your response as to how the administration is reacting to the problem of increased out-of-pocket costs on beneficiaries with respect to Medicare.

Mr. DARMAN. I think it is a problem. It is a problem, though, I would argue, with the whole Medicare system. By the way, it is a problem for which I don't contend we have a fully satisfactory answer, nor do I know of anyone else who has a fully satisfactory answer.

But a more basic problem is that health costs in the system as a whole are rising so much more rapidly than can be sustained over the long term. And the question is: How can we restrain that growth? What is the most effective way to restrain that growth?

Ours is an approach which is at best second-best, and it is a highly regulatory approach, to continue to restrain the growth of costs.

Most of the burden of our proposals would fall on providers and not on beneficiaries. The one that I think you must be referring to that would affect beneficiaries is just a continuation of current policy, with respect to the SMI premium floor at 25 percent, and that would of course—this, if I might say, is an aside. This is one of the anomalies of Medicare and the baseline. The baseline assumes the floor will disappear. If we just keep current law, we will get substantial savings by keeping that 25 percent premium floor. But you are right, or what I would expect you to say would be, that that does increase the burden on older Americans. But it is an amount of $1.40 per month—not trivial, but also not enormous.

Senator ROCKEFELLER. Let me ask you, if I might, a question on physician services. Medicare expenditures for physician services have been growing at an annual rate of about 15 percent. Increased enrollment is responsible for about 2 percent of that growth. Increases in volume and intensity of services is responsible for really the rest of that growth.

Now, your budget proposes a number of reductions in the price that Medicare will pay for physician services.

Mr. DARMAN. Right.

Senator ROCKEFELLER. But it does not propose any structural changes in the program that would help with the increased volume issue, which is the larger issue.

In fact, your budget proposal, to my way of thinking, may make matters worse, because there is a lot of evidence that suggests that every time we freeze the price, there is an increase in the volume of services provided.

Do you have any proposals that address this sort of volume increase problem?

Mr. DARMAN. Well, you are right in your analysis, in my opinion, and that is that this emphasizes controlling the prices but doesn't adequately get at the volume issue, and there is an opportunity, in effect, to beat the system with increased utilization. That has happened again and again in the health care system. Unfortunately, there are only two ways to deal with this that I can think of, analytically:

One is, you try to head towards a more competitive system, more market-oriented in some respects, in order to keep the price and utilization down. The other is to increase the regulatory structure, to put caps on the total resources that are available.

Our society, our political system, has been unable to decide which way to go, so we are always left in this middle ground, with what I said is inevitably a second-best solution. But nobody either has a fully satisfactory first-best solution or can get others to agree on it.

If you want to head in a more regulatory direction, the direction you go in is you put caps on, to address the problem you are talking about, I think. Isn't that what you would say is the next step? You put volume caps on.

Senator ROCKEFELLER. That would be one step, yes.

Mr. DARMAN. And that, of course, then leads to all kinds of arguments about, "Well, what happens if you have reached the volume cap and you are going, then, to have people not able to be served?" So then you are driven to say, "Well, we have got to decide. We are going to parcel out the volume sort of month-by-month, week-by-week, class-of-beneficiary by class-of-beneficiary," and pretty soon that system starts to look absurd in the regulatory direction. And it is a hard problem.

Senator ROCKEFELLER. I understand your dilemma, and I certainly understand ours. Let me pursue the matter of limits on actual physician charges.

In 1986 the Congress placed limits on the amounts that doctors could charge Medicare beneficiaries in addition to the amount that Medicare determines is reasonable. These are called MAAC's—maximum allowable actual charges. The MAAC limits are going to expire at the end of 1990. Without these limits, it is not inconceivable to the human mind that physicians would be free to charge beneficiaries any amount that they choose, regardless of what Medicare might say is reasonable.

Now, your budget includes a number of payment reductions for physician services that would be effective in 1991, but it does not include a proposal to continue these maximum allowable charges. Do you think that there should be any limit on the amount? If so, why is it not reflected? And how should this matter be approached, in your judgment?

Mr. DARMAN. You are correct, Senator Rockefeller, that our proposals are silent on the question of whether there should be such a limit. And in the spirit of full disclosure, I will confess that before Ways and Means, when I was asked this question, I said that I would reconsider it. But I have to add that, having said that, I said it on my own authority, and the administration hasn't taken a position on that yet.

So, we will reconsider that question, and I don't mean to be suggesting where we would come out. I simply agree that it is a problem in the approach that we have that has got to be addressed, in my personal opinion.

The CHAIRMAN. Thank you.

Senator ROCKEFELLER. Thank you, sir.

The CHAIRMAN. Senator Durenberger?

OPENING STATEMENT OF HON. DAVID DURENBERGER, A U.S. SENATOR FROM MINNESOTA

Senator DURENBERGER, Thank you, Mr. Chairman.

Let me just say for the record that I am glad you confined the opening statements to the chair and the ranking member, because, between the two of you, you said it all in as far as the health care area is concerned. I want to endorse everything you said in your opening statement.

The CHAIRMAN. Thank you very much, Senator Durenberger.

Senator DURENBERGER. Mr. Darman, we have been at this for quite some period of time, all of us together, and the point you made in response to Senator Rockefeller's comments about whither the American health care system is pretty accurate—the options being continue with choice and competition in the marketplace, or go to some other form. And I think the conclusion you drew is a correct one, also, that our society has been unable to make that decision.

I would suggest to you that one of the problems and the difficulties in making that decision is because, at least from our standpoint here in terms of leadership, the leadership on the issue needs to come, in my view, probably best from the President, or at least someone on whom the country can focus.

Because of the nature of this country, we have a private delivery system—hospitals and doctors. They aren't run by the Government. We don't have a history as Canada does of State-by-State regulation of the system.

We have got a marketplace that is dysfunctional. That is our problem. We have 20 percent or 22 percent of that market, 52 million people, in Medicare, Medicaid, and maybe you add a few more when you get to Champus and the VA and so forth. Maybe you get up to 25 percent of the people who are in some kind of a third-party payment system where the Government is the payor, and everybody else is out there in large part working for someone else, getting either free health insurance or getting some sort of a payment to get sick.

So, it is kind of hard to look any place for leadership to make this decision.

I guess my question of you is: As this administration looks to the future of the economy and the deficit and so forth, it is pretty clear that $110 billion in Medicare and the additional money in Medicaid, and so forth, it is pretty clear that the $550 going to $600 billion in hospital/doctor in this country as a whole is by far the fastest growing and most inflationary part of this economy.

So I am curious to know what sort of thinking is going on in the White House about providing some national leadership to help this country make a decision as between the various approaches that we need to go in.

Mr. DARMAN. Well, I have said already, and I take it we may agree, that the approach we are all working on is second-best, but nobody can seem to agree on what the first-best alternative is.

We will have within the administration studies of what would be the first best, and those of course have to be interrelated with some other very big-ticket issues, as you know, one having to do with long-term care, another having to do with the next steps in catastrophic, and another having to do with what to do about the 37 million or whatever number of people are not adequately covered with health insurance at the moment.

Those are all extremely difficult big-ticket issues. And we will have our own studies of that.

The reason I am a little reluctant to step forward and say "we will have an administration study of all of this and a wonderful new plan" is that I have been through this several times before. I was involved when we did this first in the Nixon administration, as Senator Moynihan—who is not here at the moment—will recall, because he was in the White House at the time. We had a comprehensive review at the start of the administration. We had a "bold new health insurance approach" in that administration, or so it was described at the time, and it didn't get too far, and most of the others that have been put forward over the years haven't gotten too far.

So, while we, too, will engage in this fresh study, and we will undoubtedly have our own new proposals for the longer-term approach to this, I think we shouldn't use that as a reason to get away from the need to address the system as it exists, imperfect as it is, and the need somehow or other to restrain the growth within the existing system.

Senator DURENBERGER. Then I take it the answer is that it is something you are working on, but there is not an answer right now to the overall system.

Mr. DARMAN. No, not right at the moment.

Senator DURENBERGER. Then let me ask you a question. Again, it will be somewhat general but directed to the budget that is before us:

I have looked over, as everyone else has, the proposed savings in Part A and Part B in Medicare, and I agree with your thesis, the Wonderland section you skipped, or whatever it was, that just continuing current law saves a lot of money and all that sort of thing, that it isn't fair to call all of this "cuts," and so forth.

But I need to suggest to you an alternative for looking at this. There is about $1.5 billion in Part B so-called savings, some of which I would suggest we could accomplish without a lot of difficulty, and there is about $5 billion in Part A savings if you include the imposition of the State and local government employees.

But my question is this: If in fact "in making choices it is important to note the voters of the present are well-represented, the citizens of the future less so," and everything else that is in your statement which reflects the view of this administration, including incentives for child care, special obligation to the poor, the scourge of drugs, investment and research, education, enterprise,and productivity, which I have taken out of your statement?

Why wouldn't you suggest that we use some of this $1.5 billion in savings, perhaps all of that savings, to expand, further than you are willing to expand in your budget, infant mortality programs, maternal and child health, expand the access to Medicaid beyond the 130 percent of poverty, do something to force the States to get their payments up on Medicaid, where they are way below costs in most States, doing more in early childhood education, child care?

Let's go to Part A. How about doing something with the $5 billion to rectify the inequities that the Chairman spoke about in the present PPS system, where rural hospitals are being reimbursed below their costs, to say nothing of below their charges? To do something about financing a severity index? To do something about putting prevention benefits into this section? Why don't we see more of that use of the savings from the administration?

Mr. DARMAN. Because we have scarce resources, in aggregate, and the uses to which any savings can be applied have to be traded against each other.

I don't deny that the ones you have suggested are worthy uses, but there are many others on the list that people take to be every bit as worthy, and some people argue are more worthy.

President Bush came out where he did—if we could live within he overall cap, there is plenty of room to argue about what is the right set of priorities.

Senator DURENBERGER. But if you have a hospital trust fund, a trust fund, payroll taxes going into a trust fund, what is a more worthy use than hospitals?

Mr. DARMAN. But there is a problem. What is happening with Medicare and its growth is that in effect it is taking away from other programs—not just from defense, which has become the first target for an offset in the budgeting process. What has happened is that we are meeting the overall budget targets by restraining the growth of non-defense discretionary programs.

And there is a very significant trade here among categorical programs for poor people, some of them performing exactly the same services you were just talking about, and this particular entitlement program.

As long as this entitlement program has got costs just going out of sight, the restraint on the other programs is a necessary corollary.

If we could take the money that you're talking about saving, allocate it to the purposes that you are talking about, and not have to increase the discretionary accounts for those exact same purposes, if that were the offset, then the numbers would still work. But if it is additive, they won't.

The CHAIRMAN. Senator Chafee.

OPENING STATEMENT OF HON. JOHN H. CHAFEE, A U.S. SENATOR FROM RHODE ISLAND

Senator CHAFEE. Thank you, Mr. Chairman.

I want to welcome Mr. Darman back here. I think, as he mentioned, he participated in some of the most exciting days we have had in this committee, and it is nice to see him back.

I would just like to touch on the Medicaid program briefly. I applaud President Bush and you for not attempting to go through that exercise we have been through so many times here, with an attempt to cap Medicaid. You haven't done that in this budget, and that is right.

And I am glad to see the expansion of Medicaid. You go up to covering 130 percent of poverty. Now, you have paid for some of that by eliminating the enhanced matching rates for some activities by the States. In other words, activities we have been trying to encourage—fraud control, computerization, and family planning. What is your rationale for that? Am I into an esoteric area?

Mr. **Darman**. No, no. You are correct, Senator. I mean, whether it is esoteric or not, your point is correct, at least with respect to the match for computer programs.

At least I have been led to understand that what is happening there is that most of the move towards computerization has already taken place, and that the need for the match was legitimate some number of years ago, but the need for the special match is no longer present.

People recognize now the efficiencies to be gained from use of computers, and you don't need a special Federal match in order to encourage them to use them. And all that is happening now, I am led to understand, is that people are gaming the system a little bit in figuring out ways to steer costs to qualify under the higher match heading rather than the overall general match.

Senator **Chafee**. Well, that may be true, and I am sure we are going to hear from the States on that.

Another area that concerns me is your $5 billion savings in Medicare. That has been touched on, and I would like to just follow up with what Senator Rockefeller said.

I have been on I guess every one of the conferences with the House on this subject, where over the past five years we have cut about $30 billion out of Medicare, pursuant to the Budget committees' requests.

As Senator Rockefeller said, two things happened. One, we squeeze one place and it bulges out another place, so you don't get the savings. The other is that we get into micro-management. In these conferences, we are practically dictating the surgical procedures on cataract operations and mandating therapeutic shoes for those who have had diabetes.

But my real point is this: I have participated in those cuts on the providers, but I really do believe we have squeezed as far as we can go. Certainly that is my experience with the hospitals in my State. And it is like getting that last bit out of the toothpaste tube; you squeeze it and more comes out, but finally you don't get any more. And we have run into that situation here.

I believe that what you have requested primarily—of course, I am talking about Part A now—on your medical education is impossible to achieve without doing severe damage to the hospitals or to the medical system.

Have you got any rationale or support for the cuts you have dictated, or the "reduction in increases," I suppose, under your Part A?

Mr. **Darman**. If I could make a couple of comments, Senator Chafee, first of all, some of the things we are recommending you have already legislated in the past—they are not new, they are operating in the system at the moment—and all we are asking is that you don't change them and you'll save almost $2 billion. In other words, capital reimbursement at 85 percent saves $930 million; just keeping the 25 percent floor in Part B saves another $714 million; and the clinical lab reimbursement almost $200 million.

Senator **Chafee**. Now, wait a minute. I don't think anybody around here has talked about increasing the cap—

Mr. **Darman**. But that is $2 billion out of our five.

Senator, with respect, may I make one very important point that I didn't read in my testimony? When people say you are "cutting Medicare by $5 billion," two of the five—two of the five—is doing nothing but keeping those provisions, because, unfortunately, the base line assumes that they will disappear.

Senator **Chafee**. The 25 percent will disappear?

Mr. Darman: Yes, sir. So, two of the five that we are proposing can be achieved by doing nothing other than keeping the existing provisions. So we really should be arguing about the remaining three, which is where your education reimbursement issue arises.

Senator **Chafee**. Right.

Mr. **Darman**. And there, what we are proposing is that the rate be 4.05 percent. The justification for that I do not have adequately before me, but what I can tell you is that it is recommended by GAO as the appropriate reimbursement rate for the costs that are associated with the activity, not the higher rate. And it is also recommended by Propac. I haven't read the back-up analyses, but those are both respected analytic organizations for this purpose, and they both conclude that 4.05 percent is the appropriate reimbursement rate.

That, I may say, if they were right—and I have no reason to think they are not—that would save another billion. So we could be at three of the $5 billion just with current law provisions plus that one provision.

It is not quite as draconian as it has been presented publicly when people assume that that $5 billion is somehow or other all going to be something brand new that is squeezed down on beneficiaries.

Senator **Chafee**. No, since we have been doing this, we haven't hit the beneficiaries, and there is no intention to do that. But eventually, when you keep going after the providers, you do hit the beneficiaries. And we have been going after the doctors, we have been going after the hospitals.

My own view, having participated in this for so many years, is that we have racheted this thing down. From my own personal experiences with the hospitals I see, I think we have racheted it down as far as we can. Maybe we can wring some more out of it, I don't know. But it gets to a point where you can't do any more.

Now, this brings me to the point Senator Durenberger was making. That is, there is something wrong with our system. There is something wrong when we are spending $500 billion a year in this country, which comes out to something like $1 billion, $400 million a day, and so many people are falling through the cracks, and we are not providing the services that other industrial countries are.

Now, I can't give you a solution in 30 seconds, but I just hope that you folks are taking a look at this. What I would like to see is some demonstration efforts. Take a few States and go into a completely new scheme on reimbursement to see if we can't come up with a better system—providing more preventative service, more cognitive services, second opinions—to hold down these costs and at the same time to provide better medical care than we currently are.

The CHAIRMAN. Thank you, Senator Chafee.

Senator Moynihan?

Senator MOYNIHAN. I have no questions at this point, Mr. Chairman.

The CHAIRMAN. Senator Roth?

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE

Senator ROTH. Thank you, Mr. Chairman.

I would like to underscore what my good friend Senator Chafee has said, because, in my own experience, the hospitals who heretofore have been pretty good about trying to meet this challenge are saying that they are in a position now where they cannot afford to take further cuts.

I think he has an interesting proposal about the need for maybe some new demonstration packages, particularly in view of the fact I think we spend more on health than any other country in the world today. Isn't that correct?

Senator CHAFEE. Per capita.

Mr. DARMAN. Per capita, yes. And in aggregate, too, yes.

The CHAIRMAN. Well, I would think so. Yes, in aggregate, too.

Senator ROTH. I would like to move to a little different area, Mr. Darman. Economists of all persuasions are very concerned about the lack of personal savings. Certainly, the recent record in this country of individual savings has not been encouraging. I personally felt we took a major step backward when in the 1986 tax legislation we backed off in part from the IRAs.

I wonder what this administration is going to propose in this area, if you agree with me that individual savings is a matter of critical importance to the economic wellbeing of this Nation, as to whether any thought is being given to any kind of new initiatives, tax initiatives, to promote savings—whether it is restoring IRAs, or permitting people to save to send their children to college, or for health requirements.

But I do think this is a matter that deserves very, very careful study, and again some experimentation, to see if we can't reverse the trend.

Mr. DARMAN. I agree with you, Senator Roth, and the administration agrees with you, about the importance of savings and increasing our savings rate.

As you know, there has been a decline in the savings rate on both the public and private side. On the public side, if we get the deficit down, it will automatically—just because it is a measurement matter, an accounting matter—it will increase the savings rate by whatever amount that that is.

If we look at the private side, however, I think it is analytically more difficult as to what exactly we should do in order to increase the savings rate.

You know, because we have discussed this several times before, that I think in addition to tax incentives and other economic incentives there is a cultural problem that needs to be addressed, that can't adequately be addressed by public policy or economic incentives. There is some deeper cultural problem here that we don't yet fully understand that affects our savings rate—and by the way, not just ours but that of most of the developed world, the industrialized countries. Not only is our savings rate low, and as people often point out, lower than our major competitors, but all of us together have been in a long-term secular decline. I am not sure any of us yet fully understands that.

But to answer your question, we are studying that, trying to understand what the variables are that influence that, some of them cultural.

We are also looking at more conventional—I don't mean this in any disrespectful way—proposals that have to do with using tax incentives of one sort or another. But those are just studies that are underway in OMB, the Office of Policy Development, the Treasury Department, and the Office of the Chairman of the Council of Economic Advisers.

We don't have specific new proposals at this stage. We agree with you that it is a problem.

Senator ROTH. I would just like to say, as one Senator, I think it is important that we not only study the matter but begin to take some new initiatives in this area.

I understand that there is a lot of disagreement among economists as to what effect, what impact tax incentives have. But again, I have to say, many of these same economists will come here and say we should use tax incentives to motivate other conduct on the part of the taxpayer. So I find it on rather weak ground.

The President, of course, has come out very strongly in favor of legislation on capital gains. And I notice that there is, again, a significant difference between what the Joint committee estimates would result from his capital gains proposal—I think the Joint committee says something like a $13.3 billion loss of revenue by 1993, while our Treasury estimates a revenue increase of $16.1 billion.

That sort of reminds me of what I was just saying about tax incentives for savings, it seems to be a lot in the eye of the beholder.

How can we reconcile these vast differences in the estimated cost of this proposal?

Mr. DARMAN. It is difficult. The Treasury tax policy staff people are meeting with their colleagues in the Joint committee on Taxation to try to resolve the differences. But as you know well, this is a longstanding difference, and how much they will be able to close the gap I'm not sure.

There are two basic kinds of differences that arise. One of them has to do with what you expect to be the unlocking effect of changing the rate—assets that people have held that have appreciated, that they might now sell with the lower rate, that they wouldn't otherwise have sold.

That is where the big difference is between Treasury and the Joint committee on Taxation. They are close in what will happen behaviorally in the first year, and then they move apart rather substantially for the out-years on that issue. They may be able to close that gap, and it would be desirable if they would.

The second big issue has to do with the long-term effect on growth in the economy. Neither the Treasury assumption nor the Joint committee's assumptions include a favorable effect on long-term growth. And since the principal motivation for changing the capital gains should be to increase long-term investment and growth, I think they are both wrong under that heading. But unfortunately, neither of them agrees with me on this.

Senator ROTH. My time is up.

Thank you, Mr. Chairman.

The CHAIRMAN. We will have a second round.

Mr. Darman, I know you strongly react against the idea that it is a "$5 billion cut" in Medicare in the President's budget, and I heard Senator Packwood comment on that one, too, at least not a $5 billion cut in the current baseline of services. What you are talking about, in effect, is not increasing it to $13 billion but increasing it by $8 billion.

But understanding your point of view there, what I want to ask about is on the other entitlement programs—if you are talking about SSI, Medicaid, foster care, AFDC—how the President proposes to meet those fundings, whether it is through an increase in enrollment, inflation, or whatever.

What is it about Medicare that is different? Is it because the payments don't go to individuals but go to third parties that provide the services? Is it because you think that over 11 percent of the GNP used to pay for health care services for Americans is too much? Is it an unnecessary use of services? What sets Medicare apart, from your point of view?

Mr. DARMAN. Thank you very much, Mr. Chairman. You will recall I skipped over part of this in my summary of my statement. But if I could just refer you to the section that begins "Changing a Habit of Mind, Wonderland Budgeting," in the third paragraph. I think I will just refer to it, and then I will elaborate, what is different.

The CHAIRMAN. All right.

Mr. DARMAN. It says, "The Curious 'current services' baseline increases Medicare expenditures for inflation, utilization, and growth in the beneficiary population, as 'current services' projections typically do."

That part I would have no quarrel with. It is an entitlement program, and it needs to be inflated for growth in the beneficiary population, for inflation, and so on, in calculating a current services baseline. And that is the same basis on which we have estimated, and CBO has estimated, SSI and the other programs you referred to, and they are all fully funded.

Medicare has another peculiar characteristic in the baseline, and it is noted in the next sentence. It says, "But not only does it thus automatically inflate expected program costs"—the way others do—"it also conveniently assumes that several current provisions will all disappear," and those are the provisions noted in our Appendix N, which include capital at 85 percent of cost allocation.

What the baseline assumes is that the existing 85 percent capital reimbursement rate will disappear. It assumes that the existing 25 percent floor on Part B premiums will disappear. And it makes an assumption also about a provision that has to do with reimbursement for clinical labs, that that will disappear.

Now, if we just did the growth in Medicare the way you would do it for those other programs, without the disappearance of certain current provisions, then Medicare would grow by $11 billion, not the whole 13, and the "cut" that we would be proposing should be construed as a $3 billion cut not a $5 billion. Or, putting it the other way around, of the $5 billion "cut"—in the conventional way of talking about this here—of that $5 billion, $1.834 billion, on our estimate, could be achieved merely by preserving the existing provisions with respect to capital costs, reimbursement, and so on.

The CHAIRMAN. Okay. Where does the other $3 billion come from?

Mr. DARMAN. The other three billion, in your vocabulary and in the conventional vocabulary—and I would accept it here—would be legitimate what you would call "cuts."

If I could, I would refer you to Appendix N. It is a neat summary of where all of these savings come from, broken out in detail. It first identifies the three that are extensions of current provisions and how much they save, and then it has got a section called "Further Restraint on Cost Growth" and on each of the provisions.

For example, if you keep the capital costs at 85 percent, you save $930 million of that five billion.

The CHAIRMAN. Let me get into that detail later, then.

Mr. DARMAN. I was going to give you further examples.

The CHAIRMAN. You have given me a good reference, and I will follow up on that, to try to better understand where you are coming from, but because of the limitation on time.

Mr. DARMAN. Okay, fine.

The CHAIRMAN. I also wanted to get into this question of the full entitlement program for jobs. It is of deep concern to me, under the Welfare Reform Bill, that we really have the training and the education for these recipients so they can work their way off of that welfare system. And I see, instead of $800 million, the administration is proposing $350 million.

I also see the language changed; it looks like it is a legislative appropriation rather than an entitlement. Would you give me your comments concerning that?

Mr. DARMAN. Yes, sir.

First of all, we are not really proposing any change, in my opinion at least, of significance. When you enacted the Welfare Reform compromise legislation—I was not party to that, but this is my understanding—the assumption was that this set of provisions, the Jobs-Win combination, would cost $800 million. That was an estimate. It is an entitlement program that is capped at $800 million as it was enacted.

We have since then received the estimates from the 50 States of what they will actually spend under these headings, and the $350 million simply represents——

The CHAIRMAN. That is what you think they will use, is that right?

Mr. DARMAN. That is what they say they will use.

Let me make one further point of clarification. We are saying not that it is no longer an entitlement but that the appropriate cap at this point is $350 million based on that estimate, not $800 million.

The CHAIRMAN. All right. Let me get through this, then.

If you are not saying it is no longer an entitlement, would you support the deletion of the language that makes the appearance that we are moving toward an appropriation item?

Mr. DARMAN. I don't know whether it is exactly "deletion," but what we would like to do is have language that amounts to——

The CHAIRMAN. Well, it undermines the entitlement program approach to it.

Mr. DARMAN. We would be happy with language that makes it clear that it is still an entitlement.

The CHAIRMAN. Okay.

Mr. DARMAN. And that, however, it is for this purpose capped at what the current reasonable estimate is. Obviously, if it exceeds that, then you would need a supplemental.

The CHAIRMAN. All right. Let me get back to my original question, and you have referenced me to the detail of that other 3 billion and where it would come from.

But that still doesn't get back to the basic question: Why is Medicare different? Why is it that you would go ahead and fund the full amount on these other programs but not Medicare? Why is that?

Mr. DARMAN. Oh, I see. I am sorry, I misunderstood the original question, I guess.

Well, I don't have an interesting answer to that, except that the cost growth in the whole health system is so extraordinary, and that is not true in many of the other programs, where really they are just being adjusted for the general inflation. And the growth there corresponds to the growth in the beneficiary population and the normal inflation rate.

In Medicare, and in the health system as a whole, that isn't the case. The health system expenditure growth rate is much, much higher than the inflation rate, which gets us back to the more general question: How in the world do you restrain that growth rate, which is way out of line with the rest of the economy?

I don't think anybody has a satisfactory answer; but I am certain that, mathematically, if we don't figure out how to restrain it, it is going to eat into the rest of the budget.

The CHAIRMAN. No question. And that is why you are going to have to have some structural changes.

Mr. DARMAN. Yes, sir. Over the long term. You are right.

The CHAIRMAN. Senator Moynihan?

OPENING STATEMENT OF HON. DANIEL P. MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. Mr. Chairman, may I thank you and other members of the committee for the diligence with which we have asked Members of the Cabinet about this question of the entitlement nature of the jobs provision in the Family Security Act.

Can I just ask our friend Mr. Darman: In responding to the Chairman, I noted that you would never stoop to a terminological inexactitude before this committee. We know that.

Mr. DARMAN. Not knowingly [laughing].

Senator **Moynihan**. But you did say to the Chairman that you agreed, and I quote you, that it was "still an entitlement," which could lead some to think a clock might be running." [Laughter.]

Would you agree, sir, that it "is" an entitlement? [Laughter.]

Mr. **Darman**. Yes, at the moment. [Laughter.]

Senator **Moynihan**. It is going to be a great 4 years, Mr. Chairman. [Laughter.]

Mr. **Darman**. No, I think it is a useful clarification. I did not mean to signal any proposed change of policy. I was merely reflecting personal concern that we are creating another very large area of potential growth.

Senator **Moynihan**. Try hard. Just say, "It is an entitlement."

Mr. **Darman**. I accept your amendment, sir.

Senator **Moynihan**. Could I just then go to the question that Senator Roth raised on the savings issue, and just ask no more than the comments you might want to have on the National Economic Commission, which addressed itself to this question? I could not more agree, why savings begin to decline. But the Japanese have almost nine times our rate at this point. Personal savings are down to 2 percent in this country. The National Economic Commission makes the point, and this was presented in the first instance by the General Accounting Office, if the United States budget were to be balanced and then go into surplus in the aftermath of the 1980s—when we incurred a debt almost equal to that of the Second World War—and if the surplus were equal to the increase in the Social Security Trust Fund Reserve, that would double the national savings rate.

That is our information. I wonder if you would share your thoughts with us on it, in terms of what is available in terms of public policy, as against the changing of mores. That is the one thing we have on hand, is it not?

Mr. **Darman**. The single easiest thing to do to change the measured savings rate is to reduce the deficit or to increase the surplus, once you are done reducing the deficit. You are correct in that respect. That, of course, is only working on the public savings rate.

The question still remains what to do about the private savings rate, and that is where one gets into the issue of how much can using the Tax Code help and/or using whatever other influences there are on cultural mores.

Senator **Moynihan**. Yes.

Could I ask you sir—and this is not in any way meant to be hectoring—you did see in the National Economic Commission report the statement of the Commissioners on our side that, if the Social Security Surplus is not going to be saved, then we ought to return to a pay-as-you-go basis.

There is a sense out there in the country, and you read it increasingly, that the payroll tax is not meant to be used to finance the general purposes of government, and in particular the idea that you are servicing a $3 trillion debt, which is owned by the wealthiest institutions and individuals in the world, with the payroll tax, you know, kind of repeals the 16th Amendment.

So, could I ask you to acknowledge that we said, "Either save it, or expect it not to be there in a few years time"?

Mr. **Darman**. Well, you are the authority on what you actually said. It was my impression that what you said—what I heard you say just now is if it is not going to be saved, we "ought" to return to pay-as-you-go. And what I thought the Commission report said was that if it is not going to be saved, we "will" return to pay-as-you-go, as a matter of prediction.

Senator **Moynihan**. I stand corrected.

Mr. **Darman**. I think, as a matter of political analysis, that is correct. I would have the same expectation. It is a guess about what our political system would do.

Senator **Moynihan**. Yes.

Mr. **Darman**. And I agree, not with the exact point you make about the "burden being taken from the backs of the poor and shifted to the bondholders who are rich"—that particular part I might put brackets around.

Senator **Moynihan**. Sure.

Mr. **Darman**. But as to the more general issue of whether we do indeed need to arrange our accounting and our deficit/surplus targets so that we do not continue to pay such a large portion of what we owe the Social Security Trust Fund out in the form of current consumption, I agree with that. We have got to address that issue.

We don't have to address it right this minute, because we have until roughly 2011 or 2018 in order to fully correct it. We have got a few years. I am not proposing we wait until the 21st century.

Senator **Moynihan**. Sir, you have about 3 years.

Mr. **Darman**. Yes, I think we have about 3. [Laughter.]

Senator **Moynihan**. I thank you very much.

The **Chairman**. Senator Packwood?

Senator **Packwood**. If I might just say a word about the savings rate, because we have to be careful about these comparisons with the Japanese, and also what we are talking about, as to whether you are talking about savings as a percentage of the gross national product, or disposable income, or whatever.

Savings as a percentage of disposable income are usually 2 to 3 percent higher than savings as a percent of the GNP. So, when people harken back to the early Seventies when our savings rate was almost 9 percent—well, it was 8.1, 8.5, and then in 1973, 74, and 75 it was 9.4, 9.3, 9.2—that was as a percent of disposable income. If you were to take it as a percent of GNP for the same three years, it is 6.5, 6.6, 6.5. So, you want to compare apples and apples.

Second, when you compare it to Japan, when you see that 22 or 23 percent savings rate, that includes private savings. That is total private savings including business savings as a percent of GNP.

Our business savings as a percent of GNP have been running consistently at 13, 13.5, 14 percent. So, the real comparative figure in terms of total saving, assuming you are using apples and apples, is more likely 15 or 16 percent against their 21 or 22 percent, in terms of total saving.

Second, when you go back into the fifties and the sixties—these were the boom years—our savings rate was never as high as the early Seventies, and our savings rate was never as high in the boom years as it was in Japan or Europe. Whether it is cultural, or whatever it was, we had tremendous years in the fifties and sixties without savings rates any disparately different from Europe and Japan than they are now.

I don't know what that proves, but we shouldn't be berating ourselves so much.

Lastly, I would take a look at the savings rate, as follows, and this is as a percent of disposable income:

In 1987 it was 3.2 percent, in 1980 it was 4.2 percent, and then for August onward in 1988, and these are the successive months, August, September, and so forth, 4.2, 4.4, 4.5, 4.5, 4.8 in December, and 5.8 in January—although that is not yet adjusted. That is just an estimate.

I think the same thing is going to happen to the savings rate that is going to happen to productivity. That is, as people get older, they are going to save more. They do save more. And we will be back to what was our historical savings rate.

If the Government doesn't blow it by doing something adverse, we will be back to our historical savings rate by about 1994 or 1995, with doing nothing. It is just, as people get older, they move out of a condominium when they have a child, and they buy a house, and when they have three children they buy a bigger house, and then they begin to save for the children's education, they save for retirement, they save more.

Then lastly, in terms of the argument that we need to go back to tax incentives, we expanded the IRA's tremendously in 1991. They existed before that, but we expanded them. And as soon as we expanded them, here is the savings rate from 1981 onwards: 7.5, 6.8, 5.4, 4.4, 4.0, and 3.2—with the IRAs. Now, if that is an argument for going back to a tax inducement for IRAs again, I fail to see the connection. I think what we discovered was that people moved their savings from something that was not tax-preferred to something that was, but they didn't increase their savings.

So I am hesitant to do anything other than nothing, for fear that we may disturb the trend that we are on of the savings rate going back up.

I have no question, Mr. Chairman.

Mr. DARMAN. May I make one comment? I believe you are suggesting, Senator Packwood, that you would do nothing with respect to private savings. You still, of course, would favor doing something with respect to public savings?

Senator PACKWOOD. I am with everybody else on reducing the deficit. I do have other questions, as we come along, as to whether we do it with tax increases or not.

Mr. DARMAN. On the private side, I think it is a very interesting issue, the generational issue and the aging issue. And Senator Moynihan in his earlier days, before he became a Senator, and even after, did quite a bit of work on just the interrelationship of demographics and things of interest that happen in public policy.

And I think you are right: This is another heading under which it will be interesting to see what just demographics do. As I suggested earlier, one is productivity and whether just doing nothing and letting the existing labor force age some is going to have a favorable effect on productivity. That is not to say it is all we should do, but whether it will have that effect.

This is another heading on which I think there is an issue of interest. But if you look at the Japanese situation, I am led to understand that there are marked differences in the savings rate by age category. I am not certain of this data. Part of it, you can assume, is a younger generation as it ages may start to save more. The younger generation saves much less, I am led to understand, in Japan.

But sociologists looking at this suggest that it may be something entirely different, and we may not be able to rely just on a natural aging process. It may be that this is the first generation that is really spending a lot of time looking at television and having its propensity to consume significantly influenced by its observation of behavioral patterns in other cultures that look quite attractive. So they don't settle for the same standard of living in housing, for example, or we could expect they may not, as they age.

So it may not be quite so neat as just relying on a population aging. There are other cultural variables that need to be looked at.

My own personal opinion would agree with what I think you were saying, which is that we ought to spend more of our attention looking at some of these cultural variables than in further tinkering with the Tax Code to try to get out of this. Although, I do think that as we make changes in the Tax Code, and there will inevitably be some, they ought to try to discourage the tendency now that tilts toward consumption.

Senator PACKWOOD. As long as my time is still here, I might just add one thing—and I say this in a complimentary fashion—that I have learned from Professor Moynihan, because I have learned so much from him over the years. This is your statement about 1981 or 1982. We were in the depths of the recession.

He says, "If I were to run for President"—he is referring to himself, not to me; but he wasn't running either—"if I were to run for President in 1984, I would promise to reduce the unemployment rate to below 6 percent and keep it there for the remainder of the decade," and, "the lowest teenage unemployment rate." I said to him, in stark amazement, "What would you do?" He said, "Nothing. Nothing." He said, "It will get there all by itself if we don't do anything." And he indeed was correct.

Senator MOYNIHAN. When fewer people were born.

Senator PACKWOOD. That is correct. In your demographic teachings, when you looked after 1985 at the drop in the birth weight, and people go to work about 18 to 20 years after they are born, they weren't being born. So, the labor force was going to grow very slowly, while the jobs were going to grow rather fast, and we would have a drop in unemployment.

Mr. DARMAN. When he was in the White House back in 1969-70, he used the same analysis, I think I am correct, in saying that we were going to have a rise in the crime rate because of the rise in the number of young people moving into—well, the change in proportion of young people.

And at the same time, the administration was trying to introduce a new management-by-objective system. The then Secretary of Education overlearned the lesson. When he was being pressed by the White House to come up with his objectives, he said, "Show me a trend, and I'll call it an objective." [Laughter.]

The Chairman. I might say the only thing that really throws in to question the projections Senator Moynihan is talking about is living on the Mexican border and watching the Rio Grande. [Laughter.]

Senator Rockefeller?

Senator Rockefeller. One question, Mr. Darman, for the record: As I indicated in my earlier round of questioning, there have been a lot of comments, letters, and phone calls—most of them quite unhappy—received by Members of Congress with respect to the catastrophic supplemental premium.

There is a $4 premium, and there is a supplemental premium that is based on ability to pay.

I want to get the administration on record. Does the administration favor in any way repealing the supplemental premium?

Mr. Darman. No.

Senator Rockefeller. Thank you.

Medicare, as you have established, is an entitlement program. It is a contractual obligation. It is an insurance program. It has mandated benefits. Philosophically, then, I suppose that all of us together are the ones who either have to change the terms of the program, or we have to pay the bills.

Now, in my overall assessment, which is the same as the Chairman's, I don't think by any stretch of the imagination we can afford to see a $5 billion cut.

You said that 36 percent of the $5 billion cut is not really a "cut," because it reflects extensions of current policy, including Medicare payments for hospital capital; fee schedules for lab tests; and extension of the requirement that beneficiary premiums cover 25 percent of Part B costs.

Now, of all three, the first and the third are due to expire. The second is due to go from regional to national, or national to regional—whichever it is, I am not sure, but it changes.

And therefore, you are assuming, that we are going to pass legislation to continue these current policies.

Mr. Darman. Right. I was not assuming it, but certainly hoping it.

Senator Rockefeller. Right.

Now, I assume you are aware that in the two-year budget summit agreement, even a one-year extension of the 25 percent premium was a major, major difficulty. And you are aware that for the first time, now, advocate groups for the elderly—and I emphasize for the first time—are coming in very, very hard saying that they oppose any further extensions, particularly in the face of the past two years of record premium increases.

I wonder if you would just reflect on what I have said, if you care to, and also if you can comment about entitlements and insurance. When we make cuts either as "deductions from increases" or however you want to phrase it; we are not paying the bills; and somehow this ends up costing the beneficiary more. Is that the way it is meant to work, or can continue to work?

Mr. Darman. Well, I would offer comments of three different types. First, if you would allow me an editorial comment of sorts, I have had an opportunity to testify for many, many hours on the question of the President's budget, and I am delighted to say that today no one has suggested that the President was unwilling to talk about "pain," he was only willing to talk about "gain," which has been a consistent theme. You were at some other hearings where this was the theme.

The reason I mention it is that he did of course propose $5 billion in Medicare "cuts," and a number of other things which were quite specific and obviously quite controversial, and as you were pointing out, there were some very large and important advocacy groups, and we too are feeling their interest and influence.

So, if you will just allow me, I would note that it is not as if this budget which we have put forward is avoiding taking on some difficult issues. Some difficult issues are addressed—many, I would contend.

I know that wasn't your question, but you asked me to reflect, so I took you rather liberally.

A second point more directly to your comments: It is my opinion—and I was not a participant in the budget summit, so I may be quite wrong; I have tried to check with several participants—it is my opinion that some participants in the budget summit knew that the day we are now approaching would come, and that they would be asked to come up with Medicare savings.

So, we have a few of these provisions disappearing against the day when someone will be able to step forward and say that they have contributed, they have provided $1.8 billion in Medicare savings. I hope we reach a day where the number is larger. But it seems to me it is reasonable to expect that we will probably get at least that minimum, and that some of the participants in the budget summit knew that it went for two years and then there would probably be a need for another one. And when that one would come around, there would be a need to have Medicare at the table, and the good way to do it would be to come up with $2 billion that really doesn't change anything, if you will allow me a somewhat cynical interpretation of what may have been going on in some quarters in the budget summit negotiations.

Finally, on the point more generally about entitlements and what it means, I agree with you, and I would suggest that current services budgeting is appropriate for an entitlement, as long as it is going to be an entitlement, but provided also there are some fair rules of projection.

I think what is going on with Medicare is technically correct, because the provisions of law do expire. But I don't think that it is reasonable to say that "current services" should mean a change in the current provisions. If we are going to inflate for inflation and beneficiary population growth, and so on, fine; but I am not sure that we should also have what I would consider artificial changes in the underlying law.

The objection to current services budgeting generally is not that. This is peculiar in the case of Medicare. The more general objection is that it tries to convert discretionary programs into entitlements. That is in effect what it is doing. I think that is a mistake. I think that discretionary programs ought to be discretionary, and we ought to view them as if they are not entitlements, not available to a whole population, not automatically inflated, and in some cases clearly temporary. That is not the way the system is working.

Each discretionary program, by the switch to current services, is gradually growing itself into an entitlement, and I think this is a mistake.

Senator **Rockefeller**. Mr. Chairman, if you will indulge me one further question?

To change the subject a little bit on this, both the Reagan budget and the Bush budget are indeed very silent on the issue of a higher update recommendation with respect to rural hospitals, and I just cannot leave this hearing without your thoughts on that.

As many around this committee have suggested, rural hospitals are in trouble, and it would seem to me that philosophically there is an obligation on the part of the administration, as there is on our part, to address the fact that the prospective payment system in fact is not working for certain rural and, for that matter, inner-city hospitals.

I would appreciate your comments on that.

Mr. **Darman**. Thank you, Senator. I don't have any very well-informed comments on this. When I was last involved with the Medicare issues, this system didn't exist. I have acquainted myself with the history and what the underlying rationale was for the original break between rural and urban, and the subsequent break between large urban and other urban, and I have been trying to get educated as to whether the difference in the treatment is in fact rational. I am not yet fully satisfied that I understand it well enough to make an intelligent comment on that subject.

I can say, to the extent that we are relevant in this equation, we are willing to work with you and other Members of the committee to try to make sure that there isn't some gross anomaly in the treatment of rural that would be unfair. But I don't know at this point what that translates into mathematically. I have seen a lot of analysis; I just haven't gotten myself to the point where I am confident in any conclusion.

Senator **Rockefeller**. I respect that. Thank you, Mr. Darman.

The **Chairman**. Senator Durenberger?

Senator **Durenberger**. Mr. Darman, while you are looking that up—[Laughter.]

I mean the best place to start. I wasn't being facetious.

Propac suggests that urban hospital operating margins are now down to about 5.6 percent, rurals are a negative six-tenths of 1 percent, and the line is going down. I think that is what Senator Rockefeller was looking for.

I noted that the President's budget makes no mention of extending the special tax rules that are allowed in connection with the merger of failing thrifts and banks. There have been a lot of reports of cases where FSLIC has transferred failing S&L's to new investors who put up less cash than the value of the tax benefits that were transferred.

My question of you is, we know the tax rules are expiring at the end of this year, and I have introduced legislation that would terminate those rules, but I don't see the administration's position anywhere in the budget.

What is the administration's view while the rules are in effect? Can you assure us that investors will not be allowed to invest less than the value of tax benefits? Do you have a plan for terminating or altering them at some point in time?

Mr. DARMAN. I believe that we are unequivocal on this, or I would be surprised if it weren't the case. We just may not have been clear yet publicly. But I think our position is that we do not favor the continuation of favorable tax treatment for the acquisition of—do you mean the NOL carry-forward provisions?

Senator DURENBERGER. Yes.

Mr. DARMAN. We do not favor the continuation of that. We could put it the other way, if you want, we "oppose it," which would be consistent, as I understand it, with what your bill would be.

Senator DURENBERGER. Yes.

Mr. DARMAN. And then to the narrower question, would we negotiate deals that would take advantage of these, that I can't speak to definitively; but I would be of the position that the answer would be no.

Senator DURENBERGER. I asked the question because Bill Seidman surprised me and I think a few other people, a little bit, by stating that he would like to see an extension, and that would put his position at variance with the President's, I think.

Mr. DARMAN. Well, in all of the discussions—and I wasn't in all of them, but I was in a lot—of the development of the plan or the assumption, it had been clear that we wouldn't. And you will notice that on our revenue measures we don't propose their continuation, and in our revenue estimates we do not assume their continuation.

So, if Bill Seidman has now reached the conclusion that he would like to have those measures available, I was unaware of that, and it is not consistent with earlier discussions that I participated in.

Senator DURENBERGER. All right. Thank you very much.

Mr. Chairman, thank you.

The CHAIRMAN. Thank you.

Gentlemen, we have other witnesses.

We have some other questions that will be put to you in writing, which we would like for the record.

[The questions appear in the appendix.]

Mr. Darman, thank you very much for coming. We appreciate your attendance.

Mr. DARMAN. Mr. Chairman, thank you. And Members of the committee, thank you. Again, it is nice to be back. It has been an enjoyable session. [Laughter.]

Thank you.

The CHAIRMAN. Our next witness is Mr. Terry Coleman, who is the Acting Administrator, Health Care Financing administration, Department of Health and Human Services.

We are very pleased to have you. Would you come forward, please?

I would say to the remaining witnesses, we are going to try to move on ahead and see if we can't complete the hearing this morning instead of going into the afternoon, as we had originally planned.

Mr. Coleman, if you would proceed, please.

STATEMENT OF TERRY S. COLEMAN, ACTING ADMINISTRATOR, HEALTH CARE FINANCING ADMINISTRATION, DEPARTMENT OF HEALTH AND HUMAN SERVICES, ACCOMPANIED BY DENNIS WILLIAMS, DEPUTY ASSISTANT SECRETARY FOR MANAGEMENT AND BUDGET

Mr. COLEMAN. Mr. Chairman and members of the committee, I am Terry Coleman, Acting Administrator of the Health Care Financing Administration, and I am accompanied by Dennis Williams, Deputy Assistant Secretary for Management and Budget of the Department of Health and Human Services.

The CHAIRMAN. We are pleased to have you.

Mr. COLEMAN. Let me begin by expressing the regrets of Secretary Sullivan, who could not be here today because of a prior commitment to appear before another congressional committee.

With your permission, Mr. Chairman, I would like to submit for the record a formal statement by Secretary Sullivan that addresses the Department's proposals which affect programs under the jurisdiction of this committee.

The CHAIRMAN. That will be accepted.

[Secretary Sullivan's statement appears in the appendix.]

Mr. COLEMAN. I will confine my brief remarks to the administration's proposals for the Medicare and Medicaid programs.

These two programs finance needed health care services to over 52 million adults and children who are aged, disabled, and poor. The Department's strong commitment to the Medicare and Medicaid programs is reflected in President Bush's 1990 budget submissions to the Congress. For 1990, we propose to increase spending by 10 percent for both Medicare and Medicaid.

Let me first address the issue of Medicare spending. Within HHS the rising costs of Medicare continue to be the primary force driving excessive budget growth.

The CHAIRMAN. Mr. Coleman, how long was your testimony in the abbreviated form?

Mr. COLEMAN. Three or four minutes.

The CHAIRMAN. Oh, fine. Go right ahead. Because we want to get to the questioning. Fine.

Mr. COLEMAN. If no spending restraints were imposed, Medicare benefit outlays would grow at a rate of over 14 percent in 1990, to approximately $110.5 billion.

However, as Mr. Darman pointed out, simply extending three provisions would retain the policies currently in effect in 1989. And allowing those provisions to expire would increase Medicare spending by about $2 billion in 1990.

The 1990 Medicare budget is based on a policy of responsible deficit reduction with savings proposals aimed at reducing unnecessary and unwarranted spending, while at the same time improving equity in payment levels for services.

Growth in Medicare expenditures for inpatient hospital services has moderated under the Prospective Payment System; however, there remain excesses in the hospital system, particularly in the area of reimbursement for capital expenditures. These excessive payments must be addressed, and we believe that this is the appropriate time to correct these problems in Medicare Part A.

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by the exigencies of the budget process, we run an even higher than normal risk of not achieving the results we want.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF TERRY COLEMAN

Mr. Chairman, Members of the committee, I am Terry Coleman, Acting Administrator of the Health Care Financing Administration. Let me begin by expressing the regrets of Secretary Sullivan, who could not be here today because of a prior commitment to appear before another Congressional committee. With your permission, I would like to submit for the record a formal statement by Secretary Sullivan that addresses the Department's proposals which affect programs under the jurisdiction of this committee.

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MEDICARE

Let me first address the subject of Medicare spending. Within HHS, the rising costs of Medicare continue to be the primary force driving excessive budget growth. If no spending restraints were imposed, Medicare benefit outlays would grow at a rate of over 14 percent in 1990, to approximately $110.5 billion.

However, simply extending three provisions—the 85 percent capital payment, the 25 percent Part B premium floor, and extending clinical labs limits—would retain the policies currently in effect in 1989. Allowing these provisions to expire would increase Medicare spending by about $2 billion in 1990. Even with other proposals totaling about $3 billion in outlay reductions, the Medicare program will still grow by 10 percent, or $10 billion in 1990, and growth in Medicare Part B costs will still be more than 12 percent.

The 1990 Medicare budget is based on a policy of responsible deficit reduction with savings proposals aimed at reducing unnecessary and unwarranted spending, while at the same time improving equity in payment levels for services. Growth in Medicare expenditures for inpatient hospital services has moderated under the Prospective Payment System (PPS). However, there remain excesses in the hospital system, particularly in the area of reimbursement for capital expenditures. These excessive payments must be addressed, and we believe that this is the appropriate time to correct these problems in Medicare Part A. president Bush's budget contains proposals to reduce the growth in Part A outlays by almost $2.4 billion in 1990.

The budget also proposes a series of steps aimed at slowing the continuing high rate of increase in the Medicare Part B program while also bringing about improved equity in payment levels for services. Part B benefit costs increased at a rate of 17 percent per year from 1979 to 1987 and 12 percent in 1988. Unlike Part A, where the government has been able to address most costs through a single overall approach (the Prospective Payment System), Medicare Part B is a very complex program for which no overall approach has yet been identified for controlling cost increases. The steps proposed in this budget are not expected to be the whole solution to the problem, but are measures clearly called for based on our current knowledge. Increased attention should lead to more comprehensive and long-range solutions to the basic problem of large and continuing cost increases in Part B.

For physicians' services, a graduated approach is taken in the budget to bring about more equitable payment levels. For primary care services, which are underpaid relative to other services, the budget proposes to increase prevailing charges by the full Medicare Economic Index (MEI) in each of the next three years. For most non-primary care physicians' services, the budget proposes to freeze prevailing charges for one year. For certain specialties and procedures that the Physician Payment Review Commission has identified as overpriced, the budget proposes to reduce payment levels in a graduated fashion, ranging from a 12 percent reduction for a number of selected procedures, to an 8 percent reduction for radiology, anesthesiology and surgery service.

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For most non-primary care physicians' services, the budget proposes to freeze prevailing charges for one year, and for certain procedures reductions are proposed.

Now let me turn briefly to the Medicaid program, which finances health care to some of the most vulnerable low-income members of our society, including 11 million children.

In his inaugural address, President Bush affirmed that as a Nation we must give our children a better start in the world and see that quality health services so critical for improving maternal and infant health will be available to the pregnant women and young children in our Nation.

We will soon send legislation to the Congress that will fulfill the President's promise to offer poor children better health care, and we look forward to working with this committee on this important social need.

Mr. Chairman, let me conclude my statement by returning to the issue of Medicare spending. We believe our proposals represent a fair and equitable approach, but the administration is willing to discuss other approaches that the Congress or others may suggest. But we must restrain Medicare growth in some manner.

We cannot allow Medicare to continue to grow at a 14-percent annual growth rate. Mr. Chairman, a 14-percent annual growth rate would result in Medicare outlays in 1995, only 5 years away, of over $200 billion. This level of growth in Medicare will make any initiatives very difficult, if not impossibie, to achieve.

Thank you. I would be pleased to answer any questions you might have.

[Mr. Coleman's prepared statement appears in the appendix.]

The CHAIRMAN. Let me get back to the question I had asked of Mr. Darman and see if I can get an answer from you on it. That is the question of allowing these other areas to grow—AFDC, SSI, Medicaid, and foster care.

Taking care of what happens with inflation, or additional users, the population, or whatever, tell me again why you think Medicare is different, and that we see the administration proposing a limitation in the growth of Medicare that they do not propose in these other services.

Mr. COLEMAN. I think there are several answers to that question. First of all, Medicare is growing much faster than Medicaid, so there is a greater reason to look to Medicare as a source of savings than there is to look like programs like Medicaid and the other entitlements, which are growing even more slowly.

Second, we have specific proposals. There are specific excesses we can see in the Medicare program that we can't see in the Medicaid program. For example, Part B physician services in Medicare is growing extremely fast. All physicians are anxious to build a Medicare program for increase in volume of services. You don't see that in the Medicaid program, where in fact many States have difficulty finding enough physicians to participate in certain aspects of the Medicaid program.

So that suggests that there is more opportunity to eliminate excesses in the Medicare program than in the Medicaid program, and it is that combination, I think, which suggests that there ought to be differential treatment.

The CHAIRMAN. Well, that was touched on, too, by Senator Rockefeller. On Part B, you talk about the substantial increase in its growth far beyond other areas. Why do you only propose to cut the prices and not propose something on the problem of over-use of services?

Mr. COLEMAN. If we had an effective vehicle to control over-use of prices, we would certainly have proposals on that.

The CHAIRMAN. Over-use of services, do you mean?

Mr. COLEMAN. Over-use of services. Cutting utilization.

The CHAIRMAN. You said "prices."

Mr. COLEMAN. I am sorry. If we had an effective vehicle to reduce over-utilization of services, we would have proposals in that area. The problem is, under the Medicare system as it is now structured, our only real handle is on price. So, our proposals are necessarily concentrated in that area. It is not what we would like. We wish we had a different system, but we have to use the only tools we have available.

The CHAIRMAN. Well, we have seen time and again that when you cut prices, physicians go to a great increase in services, haven't we?

Mr. COLEMAN. That is exactly right, and that is why the budget numbers take that into account. Our budget assumes that for every dollar we want to achieve in ultimate savings on the physicians' side, we have to actually cut $2, because there is a 50-percent slippage due to physicians increasing their volume of services, or whatever, to make up for that loss. But you still do achieve savings; you just have to start with a bigger cut in order to get those savings.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. One question—and the answer may be more or less along the same lines as the last answer.

Under the MAAC's, the maximum allowable actual charge, a 55-year-old doctor who is one of the half-dozen experts in the country is reimbursed what you reimburse a 30-year-old just out of residency. Isn't that true?

Mr. COLEMAN. It is not just the MAAC's that have that function; the whole Medicare payment system for reimbursing physicians is based on historical charges. Because of that, since the young physicians can ordinarily charge what older physicians can charge, it has that effect. You are right.

Senator PACKWOOD. As to the 55-year-old physician who might charge $3,000 for a procedure that the average doctor in the community is charging $2,000 for. Is he subject to penalties of law if he attempts to charge his patients that, assuming they are Medicare patients, even though on the basis of talent, age, and experience he could justify charging that?

Mr. **Coleman**. Each physician has individual MAAC's based on charges in a base quarter.

Senator **Packwood**. But it is the lower of three types of charges, isn't it? The actual, prevailing or customary.

Mr. **Coleman**. Prevailing, or customary.

Senator **Packwood**. Yes.

Mr. **Coleman**. The actual charge is almost always higher than the prevailing. The prevailing charge is what tends to govern what we actually pay.

Senator **Packwood**. Yes, but not his actual charge.

Mr. **Coleman**. The actual is almost always higher.

Senator **Packwood**. If it is higher than the prevailing charge, you don't reimburse him on his actual charge.

Mr. **Coleman**. That is right.

Senator **Packwood**. And if he attempts to charge the Medicare patient his actual charge, he is actually in violation of the law, isn't he?

Mr. **Coleman**. That is correct.

Senator **Packwood**. What is the reasonable basis for that? Or are you saying there is no reasonable basis. It is just what we have to work with, and we have no way of attempting to factor a difference of talent into the equation?

Mr. **Coleman**. That is what we have to work with under the present system. As I am sure you know, there are major studies being undertaken about possible reforms in the physician payment system, and we will be sending a report to Congress this summer on our review of the relative value scale report. And we are developing other kinds of possible reforms in the physician payment system which I hope could address that kind of concern.

Senator **Packwood**. Thank you, Mr. Chairman.

The **Chairman**. Thank you. Senator Durenberger?

Senator Durenberger? Thank you, Mr. Chairman.

This payment system is known by its acronym, CPR, which is another famous system, Cardiopulmonary Resuscitation. And as all of us travel in our States, we know that this system revives some docs and it kills others, which is the reason that you make such a very good point.

Mr. Coleman, I would like to remake that point. On page 3 of your testimony, where you are talking about the recommendations on freezing the Medicare economic index, you point out that "for certain specialties and procedures, the Physician Payment Review Commission has identified as over-priced, the budget proposes to reduce payment levels in a graduated fashion, ranging from a 12 percent reduction for a number of selected procedures to an 8 percent," et cetera.

There is a number of recommendations like that, and I think those of us who are familiar with the incredible disparities between some specialties in this country and primary care would not argue that we need to do something about it.

Just to illustrate the point, if you take something simple like an appendectomy, in the not so small rural community of Montevideo, MN, the same doctor performing the same appendectomy on the same patient gets paid about 23 percent of what that doctor would get in Miami, FL, for example. And if it is performed by a specialist as opposed to a primary care physician, you have the same kind of anomaly. And that is the problem.

But, getting back to what Senator Bentsen asked you, and relating to the two questions that we just heard here, you said something about all physicians want to bill Medicare for these services, and I want to ask you the volume question. Because we can freeze, and we can cut these specialists like you recommend, but if we can't control the volume of procedures, what have we accomplished?

The reality is that in our small towns out there, whether it is a primary care physician or a specialist, they can't, in many cases, balance bill. They can't increase their volume, because the economics won't permit that to happen. But in all the rest of the country you can. In Miami you can increase volume until it is coming out your ears.

So, what is the good in recommending to us these kinds of freezes and caps and so forth, when you know you can't control the volume across the country?

Mr. **Coleman**. Senator Durenberger, as I said before, there are partial solutions. Although we cannot control volume, it is our experience and our belief that physicians cannot fully make up their lost income through increased volume, that we do achieve significant budget savings, and that, to the extent that we are now paying more than we ought to be paying for these kinds of services, we do achieve a certain amount of savings.

Senator **Durenberger**. Do you think you could prove the budgetary savings from the 2 or 2½-year freeze we put on Part B payments to physicians? I mean, your data here shows an incredible rise in Part B expenditures. How did we save anything, except in the rural areas and the places where people couldn't expand their volume?

Mr. **Coleman**. There are studies that have looked at the question of what went on during the Nixon price freeze and during the more recent freezes, and they are ambiguous, because there were so many things going on in the medical community at the same time. It is difficult to isolate out how much of the volume was due to the attempt to beat the freezes.

Senator **Durenberger**. Yes. And you can't go back to Nixon, because in those days they could cost shift very easily. If you put a freeze on in the Nixon period, you could add it to somebody's health insurance bill, or something like that. You can't do that today, because everybody is putting on a limit.

I need to ask you a couple of other questions, one on capital. Capital is one of your excesses that you refer to in your statement.

How does capital reimbursement, say in southern Texas where there are a lot of Minnesotans going down and settling for the winter and expanding the demand for hospital services, so they have got to build. In parts of Texas I imagine the hospitals are folding up, but in some other parts, because of this influx of older folks, they have got to build there—new hospitals.

How is reducing capital reimbursement to 75 percent from 85 percent getting rid of excesses in those kinds of hospital situations?

Mr. COLEMAN. Well, let me address the aggregate first. The aggregate situation we are seeing is that, in the first few years of PPS, while the non-capital portion of inpatient services was growing fairly slowly, maybe 3,4, 5 percent a year, we were seeing growth on the order of 10 percent or so a year on the capital side. It is only because you recently enacted cuts that the 10 percent has been reduced to a more moderate level.

The high rate of growth in capital seems to me to be expected when you have a two-part system, one of which is a fixed price for operating costs, and then cost reimbursement for capital. You would expect to see all kinds of costs showing up on the capital side. And sure enough, that is what we have seen.

And when you see growth rates of 10 percent year after year, you have to assume that there is more going on there than legitimate needs and building facilities.

Senator DURENBERGER. And that happens to be the problem with this particular approach—the macro approach, the 10 percent growth, can be tolerated in some hospital systems, and it is going to kill other hospital systems, which is the point I am trying to make on physicians, the point I am trying to make on capital and am trying to make on all of this.

If you continue to look at this system, macro, across the country, now sure you are going to get some budgetary savings. But you are also going to kill some hospitals, some doctors, and all the rest of this sort of thing. You can handle the capital thing differently, but not with the cap. You can handle the physician reimbursement differently, but not with a freeze.

Thank you, Mr. Chairman.

The CHAIRMAN. I have no questions. Thank you very much for your comments. I appreciate it.

We will now have a panel consisting of Dr. Robert Reischauer, Director of the Congressional Budget Office, and Mr. James Blum, the former Acting Director.

I understand they are testifying before another committee and have been delayed coming over here. [Pause.]

It is my understanding they will be here in about 10 minutes, so we will recess until that period of time.

[Whereupon, at 11:50 a.m., the hearing was recessed.]

AFTER RECESS [12:05 p.m.]

The CHAIRMAN. The committee will reconvene.

We have a panel now consisting of Dr. Robert Reischauer, who is the Director of the congressional Budget Office, and Mr. James Blum, the former Acting Director.

Gentlemen, we are pleased to have you. If you would, proceed with your testimony.

Dr. Reischauer?

STATEMENT OF DR. ROBERT D. REISCHAUER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Dr. REISCHAUER. Thank you, Mr. Chairman. I am pleased to be back here on Capitol Hill and to be part of the budget process once again, as I was 14 years ago.

With your permission, I am going to submit my prepared statement to the record and confine myself to a brief summary of the highlights of that statement.

The CHAIRMAN. Without objection, that will be done.

Dr. REISCHAUER. Reestimates by the Congressional Budget Office of the administration's budget suggest the administration has understated the size of the deficits that are likely to result from its proposals. The magnitude of these underestimates depends crucially on the budgetary treatment of the Resolution Financing Corporation, REFCORP, which is the mechanism that the administration has proposed for dealing with the problem of the savings and loan institutions. If REFCORP is treated as an on-budget Government agency, as CBO thinks is most appropriate, the fiscal year 1990 deficit that will result from the administration's proposals will be about $131 billion, or $40 billion higher than the $91 billion estimate that has been provided by OMB. These figures are laid out on page 2 of my statement.

If assets sales and REFCORP are excluded from the budget totals, CBO estimates that the administration's policies would result in a deficit of $109 billion, which is $1 billion below the sequestration level contained in the Gramm-Rudman-Hollings law, but still $18 billion larger than the administration projects for its budget.

CBO's budget deficit estimates depend not only on the budgetary treatment of REFCORP but also on economic and technical assumptions that are different from those of the administration. Differences in economic assumptions account for about $9 billion of the gap between the administration's and CBO's estimates for the deficit in fiscal year 1990, and about $78 billion of the $100 billion gap in fiscal year 1993. CBO projects that over the next five years economic growth will be significantly slower and inflation and interest rates significantly higher than the administration expects.

CBO expects economic growth to proceed at a pace of around 2 percent to 2.5 percent, rather than the more than 3 percent that the administration is now forecasting, because CBO assumes that the Federal Reserve will try to hold down the growth rate to a pace that is consistent with the expansion of the Nation's economic potential. Both the Federal Reserve and the Congressional Budget Office feel that the productive capacity of the economy will be expanding in its potential at a rate of about 2.5 percent per year over the next five years.

Different technical assumptions account for $8 billion of the gap between the administration's and CBO's estimates of the deficit for fiscal year 1990. The major technical differences are laid out on page 12 of my statement. For example, CBO expects that the administration's proposals for leasing in the Arctic National Wildlife Refuge and the auctioning of certain unassigned radio frequencies will generate about $4 billion less in fiscal year 1990 than the administration anticipates. CBO also expects defense outlays in fiscal year 1990 to exceed the administration's figures by some $4 billion and FDIC outlays to be about $3 billion higher.

On the revenue side, CBO expects the receipts generated by the current tax law to be about $9 billion higher than the administration expects for fiscal year 1990. Four billion dollars of this gap results from different economic assumptions, and $5 billion from different technical estimating procedures. Over the 1991-1993 period, CBO and the administration have very similar estimates of the revenues that are likely to be generated from current tax law. We differ substantially, however, on the probable impact on revenues of the administration's proposal to reduce the capital gains tax.

CBO and the Joint Committee on Taxation judge that after an initial period, when realizations should rise substantially, the increase in realizations won't be sufficient to offset the effects of reduced rates, and therefore there will be a $4 billion revenue loss in fiscal year 1991 that we expect to grow to about $7 billion in 1993.

Since the administration has projected a $5 billion revenue gain for fiscal year 1991, there is a gap between our two estimates just with respect to the capital gains provision of some $9 billion.

Let me wrap up this summary by comparing the administration's budget proposals with CBO's baseline projections. This is a way of highlighting the policy changes that the administration is proposing in a way that abstracts from the confusion that often is generated from different economic and technical assumptions. The details of this analysis are on page 17 of my statement.

First, under the administration's proposals, national defense outlays will be slightly above what CBO expects the baseline to be for fiscal year 1990, but it will be below the baseline for the period 1991 to 1993. The reason it falls below the CBO baseline in these out-years is that CBO has a higher rate of inflation during those years.

Second, spending on the numerous non-defense discretionary accounts, which the information provided specific proposals for, are going to be about a billion dollars over the baseline in fiscal year 1990. This estimate is a net between $3.8 billion in proposed increases, and decreases of about $2.5 billion.

Third, under the administration's budget outlays for entitlements and other mandatory spending programs in fiscal year 1990, we expect the outlays to exceed the CBO baseline figure by about $1 billion. This, once again, is also a net figure. It consists of $12 billion of reductions in such programs as Medicare, farm price supports, and Federal retiree benefits, balanced against an increase of $12.8 billion in the deposit insurance accounts; and, in addition, a small amount that is attributable to the outlay impacts of the child care tax credit.

Details of the changes for entitlements which are of particular interest to this committee are shown on page 21 of my statement.

By 1993, these changes grow in size to some $17 billion in reductions below the CBO baseline. After the deposit insurance crisis is resolved, the only major increases proposed in this category is the increase for a child care tax credit for working families with young children.

The CHAIRMAN. Maybe we had better interrupt at this point and try to get some questions in, Dr. Reischauer.

Dr. REISCHAUER. Okay.

The CHAIRMAN. Educate me on the difference in your judgment as to what should be done on REFCORP, insofar as it being on-budget or off-budget as related to the administration's position.

Dr. REISCHAUER. Well, I think there are two different dimensions to that question. One is whether REFCORP should be on- and off-budget. The other is whether the expenditures of this entity should be considered as part of spending for the Gramm-Rudman limitations or not.

We are a believer that REFCORP should be on-budget.

The CHAIRMAN. Tell me, is it totally off-budget? Or is it partially off-budget? How is it structured?

Dr. REISCHAUER. Well, REFCORP itself is totally off-budget, or the administration hopes that it will be considered totally off-budget, but the draft legislation does not explicitly say that. They would like to have it totally off-budget.

It will borrow $50 billion over the next three years, and it will also receive some income from the Home Loan Banks. The proceeds of the borrowing will then be shifted to an on-budget agency and counted as offsetting receipts, therefore causing the deficit to be reduced when these resources come on-budget. And the RTC, which will be the entity which receives these proceeds, will then——

The CHAIRMAN. Well, let me understand. They are not charged with it at one point, but they get credit for it as it comes back in, as those bonds are paid off? Is that what is happening?

Dr. REISCHAUER. No. The bonds are going to be paid off by the purchase of a zero-coupon bond, which I believe will be purchased by REFCORP at the beginning. So that isn't the issue. The issue is the interest payments, and the interest payments by and large will be supplied by Treasury.

So, it is the creation of an off-budget entity which does some borrowing, has some proceeds, transfers those proceeds to an on-budget agency, which then disburses those proceeds to resolve the thrift problem. So there will be money coming in and money going out, but the process of the money coming in will cause the deficit to fall, because it will be scored, under the administration's plan, as an offsetting receipt.

The CHAIRMAN. That was my point. I wasn't clear on that. That was the point I was getting to.

Dr. REISCHAUER. Yes. And we believe the whole kit and caboodle really should be on-budget.

The CHAIRMAN. But they don't take the hit for the borrowing; it is being done by another group off-budget. But as it is paid off, then that income is utilized to help cut the deficit, as that income comes back as interest. Is that right?

Dr. REISCHAUER. No. What is happening is, REFCORP is borrowing. It takes those proceeds and transfers them to the RTC. The transfer of resources between an off-budget agency and the on-budget agency is counted like a revenue—it is an offsetting receipt. The administration would like it to be scored as that, anyway.

That acts to reduce the deficit. That entity then uses the proceeds to resolve the thrift problem, to close insolvent thrifts, to encourage mergers of one sort or another. That expenditure is counted as an outlay, which increases the deficit. So, you have those two things going on.

We then have a lot of outstanding obligations of REFCORP which will obviously need interest payments, and the interest payments will come from a variety of sources, the vast majority of it from the Treasury.

The CHAIRMAN. Will part of that come from FSLIC, for example insofar as the additional premium that is levied on the surviving S&L's? Will part of it come from that?

Dr. REISCHAUER. Yes, but a relatively small amount.

The CHAIRMAN. Thank you.

Senator Moynihan?

Senator MOYNIHAN. Mr. Chairman, I am not about to reveal my abysmal ignorance of the subject. But we are going to have to learn it up, aren't we?

There is one question. In FSLIC contributing to the retirement of bonds, isn't there a problem of the regulators being able to raise the rate of contribution by the member institutions in order to do this, to the degree that the investors in the institution can't know what their rates will be in the future period?

Dr. REISCHAUER. Yes. The administration's plan does call for a fairly modest increase in the assessments by the savings and loan institutions for a temporary period of time. Most of the assessment income that shows up in the administration's budget presentation is actually an increase of the assessment on the banks for the Federal Deposit Insurance Corporation. That money—increased premiums or assessments—will come into the FDIC. It will show up on the budget as an offsetting collection, thereby helping to reduce the deficit. But the monies will not be used for solving the S&L problem. That is to be reserved in the FDIC for the deposit insurance for banks.

Senator MOYNIHAN. Thank you very much.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. As the administration has structured the savings and loan REFCORP, it is not counted for purposes of Gramm-Rudman-Hollings at the moment, is that correct?

Dr. REISCHAUER. Correct.

Senator PACKWOOD. And your estimate of the President's budget, absent REFCORP and absent asset sales, is a $109 billion deficit?

Dr. REISCHAUER. Yes.

Senator PACKWOOD. And OMB estimates that estimate that at about——

Dr. REISCHAUER. Ninety-one.

Senator PACKWOOD. Ninety-four, not counting asset sales.

Dr. REISCHAUER. Correct.

Senator PACKWOOD. So, if the President's budget was adopted, we would technically fall just below the $110 billion needed to trigger Gramm-Rudman.

Dr. REISCHAUER. Correct.

Senator PACKWOOD. All right. Of course, we are bound by OMB's estimates when the Gramm-Rudman trigger falls; but, if by chance we got to midsummer and OMB's estimates were above the $110 billion figure on the deficit, then the sequester is triggered, unless we do something in the intervening period. And then we have to get down to $100 billion, not $110 billion.

Dr. REISCHAUER. Correct.

Senator PACKWOOD. All right.

So if we do nothing—we don't pass any appropriation bills, we don't reach a budget, we just dead-end, the Congress and the President—then we are going to have a deficit next year, assuming our estimates are correct, of $100 billion. We are going to have a sequester.

Dr. REISCHAUER. With sequester, yes.

Senator PACKWOOD. That may be arbitrary, and it presumes after we have exempted a few things, Social Security and others, that nothing has any higher priority than anything else—education is equal to highways, and they are equal to Forest Service, and they are all equal to the Coast Guard.

Dr. REISCHAUER. Excuse me. We would have a deficit of $100 billion under the administration's estimate as of the middle of October.

Senator PACKWOOD. Yes.

Dr. REISCHAUER. You know, our estimate, given that there are these differences in technical and economic assumptions, will probably be at that time a higher deficit than $100 billion.

Senator PACKWOOD. Yes. I shouldn't say "we will have it." That would be OMB's estimate.

Dr. REISCHAUER. Expectations, correct.

Senator PACKWOOD. And by law, whatever reasons, right or wrong, we chose to take OMB's estimate as the estimate we are bound by when we come to the trigger on the sequester.

Dr. REISCHAUER. Correct.

Senator PACKWOOD. Now, I do not understand—and I raised this argument when the two of you weren't here—how tax increases are supposed to narrow the deficit, unless we lower the Gramm-Rudman targets. It seems to me everyone that I know of, short of Senator Hollings, is talking about tax increases as a method of ameliorating budget cuts, or increasing the rate of increase a bit more than we would otherwise increase it under the budget. But we don't actually reduce the deficit with a tax increase, do we? We increase spending with a tax increase.

Dr. REISCHAUER. Well, the question is, compared to what? And the assumption that the deficit will be $100 million, no matter what, because we will have sequestration; then, unless you enacted a tax increase after sequestration went through, you know, the deficit would not be affected by the tax increase. The amount of sequestration would be affected.

Senator PACKWOOD. Let me ask the question in a slightly different way, then. Let us assume that OMB estimates in midsummer that the deficit for next year is going to be $130 billion, and let us say by chance you agreed with them. So now we are $20 billion above the $110 billion target. So, absent anything, a sequester would reduce the deficit to $100 billion. And let us say Congress doesn't want to do that, we don't want to see that spending restraint. If we were to agree to a $30 billion tax increase, and even if the President were to agree to it, it doesn't make the deficit any lower, does it? It just, thereby, increases the spending $30 billion above what we would otherwise spend if we took the sequester.

Dr. REISCHAUER. Arithmetically, I think you are right. If you hypothesize a tax increase of $21 billion, which would bring the deficit down to $109, just below the sequester limit, then a sequester would not occur.

Senator PACKWOOD. We would have a $109 billion deficit.

Dr. REISCHAUER. You would have a higher deficit.

Senator PACKWOOD. I thought I saw Mr. Blum shaking his head when I premised the question. Or was I wrong?

Mr. BLUM. No, I was just following your exposition, Senator.

If you had a $30 billion tax increase, or $21 billion, as Dr. Reischauer has just pointed out, and there was no other action taken, then obviously you would reduce the deficit below the $110 billion threshold, and you could avoid sequestration.

I detect in your remarks, though, that you think that any tax increase is going to be accompanied automatically by a spending increase?

Senator PACKWOOD. No. Well, we get into this increase/non-increase, cut and non-cut argument.

What I am saying is, if we have a projected $130 billion deficit, which if we don't do anything else we are going to cut to $100 billion with the sequester, that is spending $30 billion less than we would otherwise spend.

Dr. REISCHAUER. Correct.

Senator PACKWOOD. Now, if we passed the $21 billion tax increase, my hunch is we are going to spend $21 billion more than we would otherwise spend under Gramm-Rudman. We will indeed spend it. We won't use it to reduce the deficit; we will use it so that we don't have to reduce the spending.

Dr. REISCHAUER. No, but if you did that, if you had a tax increase of $21 billion and that caused a spending increase of $21 billion, you would be back at $130 billion, in which sequestration would come into effect, and you would be down to the $100 billion.

Senator PACKWOOD. That is why this term "cut in spending" is confusing. I am assuming we wouldn't use it to support an additional $21 billion, but we would use it to save us from having to do the sequester and reduce the spending by $21 billion.

Dr. REISCHAUER. Okay.

Senator PACKWOOD. But I keep seeing this statement in the press that we must have a tax increase to narrow the deficit. I don't see any way that it is going to narrow the deficit, short of lowering the Gramm-Rudman targets. What it is going to do is to save us from having to reduce spending. Or, to put it in Director Darman's language, it will have to save us from increasing spending $21 billion above where we would otherwise spend it.

I am not sure I even phrased that one right. [Laughter.]

I think the last question was an ineptly asked question.

I think I understand that a tax increase will not reduce the deficit unless we reduce the Gramm-Rudman numbers, absent any other change. Is that correct?

Dr. REISCHAUER. Or unless the tax increase is larger than the amount necessary to bring us down to the Gramm-Rudman threshold. If you passed a $50 billion tax increase, and you didn't accompany it with an increase in spending——

Senator **Packwood**. You could use $20 billion for spending and $30 billion for deficit-reduction. I understand.

Dr. **Reischauer**. Or $50 billion to reduce the deficit.

Senator **Packwood**. Yes.

I have no other questions, Mr.Chairman.

The **Chairman**. It seems to me what you are saying is that you think a tax increase would be used as a substitution for possible cuts in spending, and therefore it doesn't accomplish what you set out to do.

Senator **Packwood**. I think the deficit is going to be the same amount whether we have the tax increase or not.

The **Chairman**. That is the point, because you think it becomes a substitute for further cuts.

Senator **Moynihan**. But the Coast Guard might have a different size.

The **Chairman**. Yes. I guess the argument is, on the other side, by those that feel that the economic assumptions here may be overly optimistic, that the cuts cannot be effectively accomplished, and we can still save some of the things that have to be saved.

Senator **Packwood**. No, I think the debate is phrased in the wrong terms. We are stuck with using OMB's assumptions, but assuming that we were using CBO's assumptions——

The **Chairman**. Okay. I understand.

Senator **Packwood**. The debate really ought to be phrased on are the services sufficiently valuable, that this country ought to engage in, that we would think that a $21 billion tax increase is legitimate to preserve them, as opposed to that $21 billion of services being cut under a sequester.

The **Chairman**. Well, that was the last part of my statement. I said that is what, in effect, you are arguing.

Senator **Packwood**. Yes.

Dr. **Reischauer**. A very different set of programs might be cut under the two scenarios that you have laid out.

Senator **Packwood**. Oh, I agree. I would much rather, frankly, do a budget than do a sequester, to reach the same amount; because, at least then, we would exercise some judgment as to what we thought our priorities were.

The **Chairman**. How about some further questions? Senator Moynihan?

Senator **Moynihan**. No, Mr. Chairman.

Senator **Packwood**. No more here, Mr. Chairman.

The **Chairman**. Gentlemen, thank you very much for your attendance today.

Dr. **Reischauer**. Thank you.

[Whereupon, at 12:28 p.m., the hearing was concluded.]

APPENDIX

ALPHABETICAL LISTING AND MATERIAL SUBMITTED

PREPARED STATEMENT OF SENATOR JOHN H. CHAFEE

Mr. Chairman, I am glad to have this opportunity to examine in more detail the administration's budget proposals for fiscal year 1990. This hearing is, in effect, the first formal exchange in what I expect will be a fairly long dialogue on this subject between this committee and the administration. Mr. Darman, Mr. Coleman, and Mr. Reischauer, it was good of you to make yourselves available to answer the committee's questions.

Let me begin by saying that I applaud President Bush's decision to disregard earlier proposals to cap Medicaid. Instead, the President has proposed to allow the program to increase to current services levels—even expanding it to cover pregnant women and children up to 130 percent of poverty. At the same time, I must express my reservation about the method proposed to pay for this expansion—the elimination of enhanced matching rates from administrative services. I look forward to working with the administration to address the President's clear and commendable concern for the health of pregnant women and children.

I am quite concerned, however, about the proposed $5 billion cut in Medicare.

In the past few years, the Medicare program has contributed more than $30 billion in savings to reduce the deficit. Each year, the Finance committee has been instructed by the Budget committee to find a certain amount of savings in the Medicare program, and we have done so, on a bipartisan basis. We have attempted to achieve these savings without jeopardizing the access to or quality of health care services for the elderly or disabled. Nonetheless, as we have restricted funds for reimbursement of hospitals, physicians and other health care providers, concern about both quality and access has increased.

We can only do so much so fast without sacrificing the quality of and access to health care. If we continue to decrease Medicare reimbursement, quality and access *will* be adversely affected These proposed cuts *will* have an impact on Medicare beneficiaries.

After 30 billion dollars in reductions over the past five years, I believe the program has contributed enough to deficit reduction to deserve a respite. At this point, I think many of us agree that the list of potential savings has been thoroughly culled. In fact, many of the proposals on the list before us today have been given thorough consideration in the past and found unacceptable.

To sum up, Mr. Chairman, I am as concerned as anyone here about the rate at which health care expenditures are rising. It is imperative that we get this growth under control. However, I can say, after sitting on this committee for ten years, and on the Conference Committees during reconciliation, that we have essentially failed to get at the root of the problem. Each year, we have toiled away to achieve savings that squeeze one area of the program or clamp down on another. The results have so often been the opposite of what we expected that I question whether we really have a handle on what ails our health care system, and therefore the Medicare program. I question even more whether we should be attempting to fix it as we have been—through the budget process.

An example: When we froze physician's fees, a miracle took place. The cost of the program remained the same, because volume increased. We had squeezed the program in one area, and it bulged out in another.

What I believe is needed is a good, careful look at Medicare and how it fits into the rest of our health care system. When we allow our policy decisions to be driven

MEDICAID

Let me now turn to the Medicaid program which finances health care to some of the most vulnerable low-income members of our society, including over 11 million children. In his inaugural address President Bush affirmed that ". . . As a nation, we must give our children a better start in the world [and] see that quality health services so critical for improving maternal and infant health will be available to the pregnant women and young children in our nation." Mr. Chairman, I am aware of the support and leadership you personally, and other Members of this committee, have provided in the area of children's health.

We will soon send legislation to the Congress that will fulfill President Bush's promise to offer poor children better health care. We look forward to working with this committee on this important social need.

The Medicaid budget proposes a series of program expansions aimed at improving the health of poor pregnant women and young children. We propose to further expand Medicaid coverage to pregnant women and infants up to 130 percent of poverty, require immunizations for all food stamp eligible children under age 6 and provide funds to implement demonstration projects to decrease infant mortality and morbidity. We propose paying for this by phasing down special matching rates for certain administrative costs which have outlived their original purposes.

Mr. Chairman, let me conclude my statement by returning to the issue of Medicare spending. We believe our proposals represent a fair and equitable approach, but the administration is willing to discuss other approaches that the Congress or others may suggest. But, we must restrain Medicare growth in some manner. We cannot allow Medicare to continue to grow at a 14 percent annual growth rate. Mr. Chairman, a 14 percent annual growth rate would result in Medicare outlays in 1995, only five years away, of over $200 billion. This level of growth in Medicare will make any new initiatives very difficult, if not impossible, to achieve.

PREPARED STATEMENT OF LOUIS W. SULLIVAN, M.D., SECRETARY OF HEALTH AND HUMAN SERVICES

Mr. Chairman, Members of the committee, I am pleased to present President Bush's budget proposals affecting programs within the jurisdiction of the Senate Finance Committee. I am pleased to enjoy the trust of our new President, and as Secretary of Health and Human Services, I shall carry out the task he has given me in such a way that the hopes and aspirations we mutually hold for this Department, and for the American people, are fulfilled.

This statement presents the broad contours of those hopes and aspirations. They center on the President's commitment—a commitment I fully share—to the ideal of a "kinder, gentler" America. No Department will be more directly affected by that commitment than HHS, which touches the lives of Americans wherever they are most vulnerable—from the beginning of life, through health and sickness, from the foods we eat to the medicines we take, to the care of the elderly and disabled.

Taking that commitment as my guide, I intend to see to it that our policies at HHS carry a firm, but gentle touch; that HHS employees take pride in the invaluable service they render our citizens; that government itself comes to have a more human face. Bringing a new spirit of kindness and compassion to a vast Federal Department may seem excessively idealistic. But it is an ideal we can and must attain. Nothing less shall be my goal as Secretary of HHS.

During my medical career, I have seen remarkable progress in the Nation's system of health care, with programs like Medicare and Medicaid making health care more available to the elderly and poor. And I have seen the improvements in the lives of millions of our children and less privileged through HHS' programs of human services.

Much remains to be done. But it must be done with an eye to reducing the Federal budget deficit—a concern, I know, of paramount importance to this committee, as you consider not only how funds are spent, but how they are raised as well.

Let me indicate how we might begin to make further progress toward improving the health and well-being of our citizens, bearing these constraints in mind.

First, we must assure the solvency of programs like Social Security and Medicare trust funds. We must find ways to contain escalating medical costs, without sacrificing our commitment to quality health care for all. And we must emphasize health promotion and preventive medicine strategies, because promoting health is ultimately more humane and economical than merely treating illness.

In only six short years since the Bipartisan Commission put the trust funds back on the road to solvency, we can report that in 1990, trust fund income will exceed outgo by nearly $69 billion. The combined reserves of the Old Age and Survivors

Trust Fund and the Disability Trust Fund will be approximately $229 billion by the end of 1990. By 1992, the trust funds will have a full year of benefits in reserve. The reserves are necessary, and will be used, to fund the benefits of the "Baby Boom" generation as they begin retiring in the next century.

President Bush proposes to increase Medicare spending by about 10 percent in 1990 compared with 1989, while at the same time seeking ways to restrain excessive growth. I will return to some of these measures in a moment.

Second, we must sustain and improve programs like Head Start and Aid to Families with Dependent Children—programs that help the poor learn and work their way out of poverty. Implementation of last year's Family Support Act will therefore be one of my highest and earliest priorities.

The Act's most fundamental change was the creation of a new program of work and training activities, the Job Opportunities and Basic Skills (JOBS) training program, which all States must have in effect by October, 1990. States can elect to replace existing work programs with JOBS as early as July of this year. I intend to insure a speedy implementation of this Act, with the issuance of program regulations early this Spring. We must do all that we can to encourage welfare recipients to become productive members of this country's workforce.

Welfare reform also made improvements to child support enforcement, and I also want to report to the committee that child support collections continue to rise. We project that increases in 1990 will exceed 1989 estimates by 17 percent, or $931 million. The strong congressional commitment to enforcement activities has helped bring this important parental financial responsibility issue to the forefront in State capitols across the country.

Third, we must seek ways to strengthen family life and reinforce our society's sense of community, our shared sense of responsibility and commitment to one another. As President Bush notes, "family . . . is a powerful word, full of emotional resonance," and those of us who have been blessed with strong families must work to bring that blessing to those who have not.

Attention to family means that the health of our children must be our particular concern, for nothing less than our Nation's future is at stake. Today, that future is threatened by the epidemic of drug abuse among our young. I am deeply committed to the battle against "this scourge," as President Bush has called it, and will work long and hard with this committee, with the President, and with his Drug Adviser in pursuit of victory.

Caring for the needs of the homeless exemplifies our commitment to one another. By fully funding the McKinney Act, this Department will assist communities in bringing to the homeless critical primary health care services, mental health care, and a wide assortment of social services. A total of $189 million is directed to these specialized McKinney Act programs.

Fourth, we must sustain our biomedical research efforts in the quest for a cure for AIDS. As the President has said, "We must commit the resources and the will to find a cure. American science must know that we have the resolve to beat this disease." At the same time, however, we must not slight our efforts to conquer cancer, heart disease, diabetes, arthritis, and other disorders afflicting our citizens.

Finally, we must focus our limited resources on the poor, the disadvantaged, and the neglected in our society. Programs like Medicaid must be carefully administered so that rural and inner city health care needs are met, and the Nation's poor are accorded decent care with dignity. We will soon send to the Congress legislation to enhance Medicaid services for children, including expansion of immunization services.

I would now like to return for a moment to the question of Medicare spending. Within HHS, the rising costs of Medicare continue to be the primary force driving excessive budget growth. If no spending restraints were imposed, Medicare benefit outlays would grow at a rate of over 14 percent in 1990, to approximately $110.5 billion. However, simply extending three provisions—the 85 percent capital payment, the 25 percent Part B premium floor, and extending clinical labs limits—would retain the policies currently in effect in 1989. Allowing these provisions to expire would increase Medicare spending by about $2.0-billion in 1990. Even with other proposals totaling about $3.0-billion in outlay reductions, the Medicare program will still grow by 10 percent, or $10 billion in 1990, and growth in Medicare Part B costs will still be more than 12 percent.

The 1990 Medicare budget is based on a policy of responsible deficit reduction with savings proposals aimed at reducing unnecessary and unwarranted spending, while at the same time improving equity in payment levels for services. Growth in Medicare expenditures for inpatient hospital services has moderated under the Prospective Payment System (PPS). However, there remain subsidies in the hospital system which are clearly excessive, particularly in the area of reimbursement for capital expenditures. These excessive payments must be addressed, and we believe that this is the appropriate time to correct these problems in Medicare Part A. President Bush's budget contains proposals to reduce the growth in Part A outlays by almost $2.4 billion in 1990.

The budget also proposes a series of steps aimed at slowing the continuing high rate of increase in the Medicare Part B program while also bringing about improved equity in payment levels for services. Part B benefit costs increased at a rate of 17 percent per year from 1979 to 1987 and 12 percent in 1988. Unlike Part A, where the government has been able to address most costs through a single overall approach (the Prospective Payment System) Medicare Part B is a very complex program for which no overall approach has yet been identified for controlling cost increases. The steps proposed in this budget are not expected to be the whole solution to the problem, but are measures clearly called for based on our current knowledge. Increased attention should lead to more comprehensive and long-range solutions to the basic problem of large and continuing cost increases in Part B.

For physicians' services, a graduated approach is taken in the budget to bring about more equitable payment levels. For primary care services, which are underpaid relative to other services, the budget proposes to increase prevailing charges by the full Medicare Economic Index (MEI) in each of the next three years. For nonprimary care physicians' services, the budget proposes to reduce payment levels in a graduated fashion, ranging from a 12 percent reduction for certain procedures identified as overpriced by the Physician Payment Review Commission (PPRC) to an 8 percent reduction for radiology, anesthesiology and surgery services, to a freeze in prevailing charges for all other non- primary care services.

Mr. Chairman, let me make two things clear: First, we are not adamantly insisting that the proposals we suggest here are the only way to restrain Medicare growth. We believe that they represent a fair and equitable approach, but the administration is willing to discuss other approaches that the Congress or others may suggest. But second, we must restrain Medicare growth in some manner. We cannot allow Medicare to continue to grow at a 14 percent annual growth rate. Mr. Chairman, a 14 percent annual growth rate would result in Medicare outlays in 1995, only five years away, of over $200 billion. This level of growth in Medicare will make any new initiatives very difficult, if not impossible, to achieve.

Finally, I wish to highlight one of the priority initiatives of the President's program. The Medicaid budget includes a series of program expansions aimed at improving the health of poor pregnant women and young children. We propose to further expand Medicaid coverage to pregnant women and infants up to 130 percent of poverty, require immunizations for all food stamp eligible children under age 6 and provide funds to implement demonstration projects to decrease infant mortality and morbidity. We propose paying for this by phasing down special matching rates for certain administrative costs which have outlived their original purposes.

In summary, I would like to reiterate what the President and other administration members have already stated. We are prepared to work together with the Congress in a bi-partisan spirit, and to put forth whatever level of effort it takes to reach a constructive budget agreement.

PREPARED STATEMENT OF RICHARD DARMAN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Chairman Bentsen, Senator Packwood, and distinguished members of the Senate Finance Committee, please let me thank you very much for this opportunity to discuss President Bush's budget proposals. I appear before you in what I hope you will find to be a constructive spirit, seeking to advance our common objective: the prompt enactment of a responsible budget program that can meet the Gramm-Rudman-Hollings deficit reduction targets, on schedule.

With your permission, I would first outline the President's overall approach to the budget and then note the very important set of proposals that directly involve the Senate Finance committee—before responding to your questions. I would also ask that the set of Appendices that accompany this testimony, and to which I may refer, be included in the record.

BUILDING A BETTER AMERICA: THE PRESIDENT'S PROPOSALS

In seeking to meet the Gramm-Rudman-Hollings objective, on time, the President has suggested that a responsible set of budget proposals must pass several basic tests:

- They must attend to fundamental obligations—such as the payment of interest, the protection of national security, and the funding of social security.
- Within the limits of scarce resources:

—they must address special obligations (to the poor, as through means-tested entitlement programs and incentives for child care; and to future generations, as through environmental protection);

—they must begin to remedy problems inherited from the past: the scourge of drugs; the crisis in the savings and loan sector; the failure to invest adequately in the modernization and clean-up of nuclear weapons production; and

—they must advance priorities for future American growth and competitiveness (as through measures to encourage sound investment in research, education, enterprise, and longer-term productivity).

—They must do all these things while also restoring fiscal balance—meeting the Gramm-Rudman-Hollings targets, without raising taxes, and without threatening what is now America's longest period of sustained peacetime economic growth.

The President's proposals were presented to the Congress on February 9 in a 193-page volume titled, *Building A Better America*. His proposals meet the several tests I have noted.

In addition to the 193-page volume, we have since provided the Congress with over 4000 pages of supplementary detail. These submissions are noted at Appendix A—and are contrasted with submissions of prior Presidents.

With these various submissions, and through informal consultation as well, I think it fair to say that we have submitted more data and explanation than any new President has done at a comparable stage of his Presidency in the modern budgeting era.

CHANGING A HABIT OF MIND: FROM WONDERLAND BUDGETING TO COMMON SENSE BUDGETING

The initial presentation of the President's proposals stirred a bit of attention for its effort to change a local habit of mind. That habit has a curious Wonderland quality. It is described by a phrase that is unknown to most of the country, but common among Washington budgeteers: "current services baseline" budgeting. I will not burden you with our general critique of current services budgeting—for I know you are now familiar with it. But let me please make clear that the critique is not confined to discretionary programs.

Some of the most curious cases involve entitlements. Consider Medicare, for example. President Bush is proposing to increase Medicare by about $8 billion in FY '90 relative to FY '89—from $84.5 billion to $92.5 billion. Advocates of current services budgeting claim that that proposed increase of $8 billion should be called a "cut" of $5 billion. This defies common uses of language. But worse: it is phony.

The curious "current services" baseline increases Medicare expenditures for inflation, utilization, and growth in the beneficiary population, as "current services" projections typically do. But not only does it thus automatically inflate expected program costs; it also conveniently assumes that several current provisions will all disappear—for Medicare's capital cost reimbursement (at 85%), clinical lab reimbursements, and supplementary medical insurance premium payments (25% premium floor) That is, current provisions are not used in calculating "current services"!

If these current provisions were to disappear, as assumed under "current services," Medicare's expenditures would be almost $2 billion higher than if the provisions were to remain as they are today. Conversely, if the current reimbursement and premium provisions were to stay as they are, Medicare expenditures would be almost $2 billion lower than the artificial "current services" projection.

So, with this curious form of "current services" accounting, *if the Congress simply decides to extend the current Medicare provisions,* Medicare will be said to be "cut" by almost $2 billion. That is, if the program increases not by our recommended $8 billion, but by over $11 billion—with today's provisions simply extended a fictitious "cut" of almost $2 billion will be claimed. I would contend that this is fundamentally misleading.

There have been too many compromises announcing heroic "savings" measured against ethereal, misleading constructs. It should be little wonder that fictional "savings" have failed to materialize.

The fiction should not continue. The deficit is rising. It's time to do something real.

SHIFTING PERSPECTIVE: FROM PREOCCUPATION WITH THE PRESENT TO INVESTMENT IN THE FUTURE

Whatever one's views on the Wonderland budgeteers' habit of mind, there is another issue of perspective that is, I think, even more important. Whether we budget from last year's levels, a "zero base," "current services," or any other reference point, it is essential that we give greater attention to investment in the future. As a matter of analysis, that means we must attend to the relative emphasis given to new spending for current transfers and consumption versus new spending for future gains in productive power and the quality of life.

Our freedom for spending initiatives is limited. We are constrained by problems from the past and obligations to the present. But within the limits set by these constraints, President Bush's proposed initiatives *tilt toward the future.*

They emphasize:

- *Investment in research and development*—with major funding increases for basic science, biomedical research, space, and the superconducting super-collider; as well as proposed improvements in the Research and Experimentation (R&E) expense allocation rules and the R&E tax credit.
- *Investment in education and child development*—with proposals for a new merit schools program; a new National Science Scholars program; increased funding for historically black colleges, magnet schools, Head Start, and experimentation and innovation; as well as a new refundable tax credit of up to $1000 for each child under 4 with a working parent in low-income families, and a related proposal to make the existing child care credit refundable; along with a restoration and doubling of the adoption expense tax deduction.
- *Investment in the protection of the environment*—with proposals for clean coal technology development, a new Clean Air Act, postponement of OCS drilling off of California and Florida; as well as tougher regulation and enforcement for hazardous waste clean-up, ocean dumping, and protection of wetlands.
- *Investment in combating drug abuse*—with proposals that would increase outlays by almost $1 billion for fiscal year 1990.
- *Investment in the creation of incentives for new economic opportunity*—with proposals for a new longer-term capital gains initiative, and provision for up to 70 enterprise zones.

The list of seemingly worthy claims always exceeds available resources. It is limited only by human imagination. The necessity for choice is inescapable. (For a summary of President Bush's priority choices, please see Appendices B and C) But in making choices, it is important to note: the voters of the present are well-represented; the citizens of the future are less so. At the margin of choice, the citizens of the future must depend upon the wisdom and generosity of a present generation that is willing to invest in the future.

BUT "HOW DO WE PAY?" GROWTH, PRIORITIES, AND BALANCED RESTRAINT

But, the question is rightly asked, "How do we finance all this?" The answer is straightforward.

The first and most important contributor is economic growth. With a growing economy—and no change in current law—revenues are projected to increase from $978.6 billion in fiscal year 1989 to $1.060 trillion. That's an increase of more than $80 billion. (The congressional Budget Office estimates even higher revenues than the administration.) That is no small amount of money: it is more than the GNP of 137 countries.

Even so, with the claims made by deficit reduction, fundamental and special obligations, problems from the past, and priorities for initiative and investment, there is also need for restraint on the growth of the remainder of the budget. This need is mitigated somewhat by certain mandatory programs that naturally decline. (See Appendix D.) It is mitigated further by our ability to make sensible reforms in programs that would otherwise be an excessive drain on limited resources. (See Appendix E.) Still, in order to meet the Gramm-Rudman-Hollings targets, there remains a need to freeze the remainder of the budget as follows: freeze all retirement COLAs for Federal civilian and military employees for one year; freeze defense budget authority at zero real growth for one year; and freeze residual non-defense spending (other than in areas of priority initiatives) at 1989 levels for one year. (See Appendix F.)

With these steps, it is possible to fund necessary and desirable program growth while also reducing the budget deficit below the target of $100 billion in FY 1990. (See Appendix I.) (*NOTE:* Using CBO technical and economic assumptions, and the administration's treatment of REFCORP, the Bush proposals would still produce a deficit estimated to be below the Gramm-Rudman-Hollings sequester trigger point.)

The net effect of all of President Bush's proposals would be to increase total spending by 1.2%. Within this total, defense outlays (including atomic weapons production/clean-up) would increase by 0.7%. All non-defense discretionary programs' outlays would increase by 3.3 %. And all other mandatory programs (including those that naturally decline) would increase by 1.1%. Since revenues are projected to increase by almost 9 %, the deficit can be reduced substantially—even as all these major expenditure areas grow.

THE FALLIBILITY OF MACRO-ECONOMIC "SCIENCE": CLOSER TO EACH OTHER THAN RIGHT

That said, I must emphasize that our exact economic and deficit projections are *not* what I would forecast. They are dependent on a host of variables and conditions that are not wholly within our control or within economists' ability to forecast reliably.

One of the key conditions is political, not economic: our projections depend upon prompt Congressional enactment of the President's program (or something close to it) Clearly, if there is not prompt and responsible legislative action to reduce the deficit, there will be greater market risks, and it will be substantially less likely that our conditional projections may be achieved in the manner intended. We would have to rely upon sequester—a clumsy way to proceed, although a necessary back-up discipline.

As for economic assumptions, these, of course, are endlessly arguable. Here I would make three general points:

- First, although *micro*-economics has much to recommend it, *macro*-economics is not really well enough developed to justify its claim to the label "science." It is highly fallible. In the period 1981–88, for example, the administration, CBO, and the "Blue Chip" group of forecasters all had large mean errors in their forecasts of nominal GNP for one year ahead—2.6% , 2.4% , and 2.6 % respectively. It is a regrettable fact of macro-economic forecasting that forecasts are often closer to each other than they are to being correct.
- Second, the administration's assumptions are perhaps most vulnerable with regard to out-year interest rates. It is at least noteworthy, however, that it is possible for others to be wrong—in addition to the administration. In 1982, for example, CBO forecast 1983 T-Bill rates at 13.2 % Blue Chip forecast 10.7% . Reality came in at 8.6 %. In 1985, one saw the same pattern. Blue Chip forecast 9.0% for '86; CBO forecast 8.7%. Reality came in at 6%.

I am not trying to suggest that the administration is right and others are wrong; rather, I mean to suggest simply that we should not have too much faith in *any* macro-economic forecasts. In the end, it is probably not a bad idea to rely upon common sense.

If the administration is wrong about interest rates, it is probably also wrong about inflation. And the combination of these errors would produce much less adverse effect on the deficit—all other things being equal—than would an interest rate error alone.

The Chairman of the Federal Reserve has said that if a program of deficit-reduction such as the President's were enacted, he would expect interest rates to come down substantially. For a host of reasons, this seems desirable. And to me it seems common-sensical that if we wish to see interest rates come down in the current context, we should move forward with responsible deficit reduction.

- Third, the administration's long term sustainable real growth projection—averaging about 3.25%—has been challenged by some who believe it should or must be lower. From 1948 to the present, however—a period that includes eight recessions—real growth in the American economy has averaged 3.25%.

I see no reason to settle for a lower long-term projection than we have been able to achieve over the past 40 years. To do so would be unnecessarily defeatist. The argument ought not to be about whether or not we should lower the future trend line. Rather it should be about what set of policies are most likely to assure that we are capable of sustaining our historic pattern of growth. For our part, we believe that policies such as the President's—that would lower the deficit, increase savings and investment, increase R&D, increase investment in human capital, and ultimately increase productivity—that these are the key to sustaining growth.

THE IMPORTANCE OF SENATE FINANCE

In implementing the President's approach to the Budget—or any other serious approach—the Senate Finance committee, quite obviously, has a fundamentally important role. The committee must address proposals in three broad areas:

—special entitlement obligations;
—receipts; and
—structural reforms of existing programs.

With respect to the first of these categories— special entitlement obligations—President Bush has proposed the following for programs within the jurisdiction of the Senate Finance Committee:

- *Full funding of Social Security benefit payments:* In fiscal year 1990, nearly 40 million beneficiaries would receive an estimated $244 billion in Social Security benefits.
- *Full funding of Supplemental Security Income benefits:* There will be an estimated 4.5 million 551 beneficiaries at the start of FY '90; and benefit payments for the year total an estimated $11 billion.
- *Full funding of AFDC benefit payments:* 3.8 million families will receive an average of $384 per month for each family—totaling an estimated $9.6 billion in Federal outlays (the rest State and local) in addition, AFDC Emergency Assistance payments totaling an estimated $275 million would be paid to families experiencing emergency needs in FY '90.
- *Full funding of benefit payments for workers eligible under the Trade Adjustment Assistance Program*—$210 million for FY '90.
- *$14.3 billion in payments for all those estimated to qualify for unemployment insurance compensation in FY '90.*
- *Full funding of Medicaid (with program improvements for pregnant women and infants near the poverty line)*—totaling $37.6 billion for FY '90, a 9.7% increase relative to FY '89.

With respect to the second category—receipts— President Bush's proposals include the following (in addition to those previously advanced by President Reagan) :

- *Adoption:* The President proposes to restore and double (to $3000 per child) the Federal income tax deduction for special needs children. (This is in addition to $138 million provided for adoption-related discretionary programs and Social Security benefits.)
- *Child Care:* As noted above, the President proposes a new, refundable child care tax credit for young children in low-income families with a working parent; and he proposes to make the existing child care tax credit refundable. The rationale for refundability is straightforward: many low-income families have little or no Federal income tax liability, and therefore cannot otherwise claim the full credit. The rationale for using the tax system for this purpose is both economic and philosophical. This approach is more efficient, and it provides parents with more choice.
- *Energy Resource Development:* The President proposes a 10% credit for the first $10 million (and five percent of the balance) of annual expenses for exploratory intangible drilling costs (effective. January 1, 1990); elimination of 80 % of minimum tax preference items from exploratory intangible drilling costs in excess of amortization and income allowances; and a 10% R&D credit for tertiary enhanced recovery. These proposals focus on exploratory activity in an attempt better to address the fact that domestic exploratory drilling has fallen sharply, and oil imports have been rising.
- *Enterprise Zones:* The President proposes to stimulate new economic activity in depressed areas by providing selected employment and investment tax preferences for activity in up to 70 enterprise zones.
- *Long-term Investment:* The President seeks to reduce tendencies toward short-term speculative activity and to increase incentives for longer-term investment and entrepreneurship. To do so, he proposes a reduction in the capital gains tax rate for financial assets held for 3 years or more (after phase-in) The proposal would not apply to collectibles and depreciable property—and it would reduce the gains tax rate to zero for families with incomes of $20,000 or below.
- *Telephone Excise Tax:* The present 3% telephone excise tax has been scheduled to expire periodically since 1959. It has again been scheduled to expire in 1990. Congress has consistently extended it in the past. To fail to do so would reduce Federal receipts by approximately $1.6 billion in FY '91, $2.6 billion in FY '92, and $2.8 billion FY '93.

With respect to the third important area of Senate Finance Committee responsibility—structural reform of existing programs—Medicare is the principal focus of interest. The administration's proposals can be conceived in two categories.

- *Proposals that would merely extend current reimbursement and premium provisions:* In total, these proposals would "save" over $1.8 billion in FY '90 relative to "current services."
- *Proposals that would further restrain the growth in payments to providers:* These would save an additional $2.4 billion under Part A and $0.8-billion under Part B of Medicare.

The total of such savings (real and artificial) would be over $5 billion. Although the specifics of the proposals differ in some areas, the administration's proposals achieve roughly the same amount of savings as would be achieved by adopting the comparable set of proposals identified by the Congressional Budget Office. Both the CBO set and the administration's set reject deep cuts that would have significant adverse effect on beneficiaries.

THE NEED TO NEGOTIATE: "WE CANNOT SETTLE FOR BUSINESS AS USUAL"

That said, I should emphasize that we do not pretend to have either all the answers or the only acceptable set of answers for Medicare or for the budget as a whole. We have offered a set of proposals that we believe have merit. We look forward to learning of other proposals—and to discussing them on the merits.

We mean to be cooperative.

But this, of course, is not enough. We cannot unilaterally produce a budget. We in the Executive Branch cannot legislate. We can offer and exchange views. But in the end, we must come to an Executive-Legislative agreement. To that end—as a matter of practical reality—we must negotiate. The only question is whether we do so promptly or late.

From our perspective, serious negotiation would best begin sooner rather than later. Although the real economy remains strong, interest rates are rising and markets seem less firm than one would wish. Our government is divided between the two great parties. That division is viewed by some as a formula for stalemate—and stalemate is fraught with risk.

The risks are economic: if we do not act responsibly, and in a timely fashion, rising interest rates may cause the economy to founder—creating significant human costs in the process. And the risks are political: if we do not act responsibly, and in a timely fashion, public cynicism about our collective capacity to govern may only deepen.

But it need not be so. The President has said that this is not the time to settle for business as usual. Our job, as we see it, is to do our utmost to make divided government work. We are prepared to work in good faith, in a bi-partisan spirit—day and night, if that's what it takes—to reach a constructive agreement.

In that spirit, I would be pleased to try to respond to your questions. May I thank you again for inviting me to appear before you today.

Attachments:

Appendices A through N

Appendix A

INITIAL PRESENTATIONS OF BUDGET DATA BY NEW PRESIDENTIAL ADMINISTRATIONS—1969–1989

During the past 20 years, the Presidency has changed hands five times: January 1969, when President Nixon succeeded President Johnson; August 1974, when President Ford succeeded President Nixon; January 1977, when President Carter succeeded President Ford; January 1981, when President Reagan succeeded President Carter; and January 1989, when President Bush succeeded President Reagan.

Because a President who leaves office following a November general election presents his last budget request to Congress in January, shortly before the inauguration of his successor, the new President is given the opportunity to transmit an amended budget to Congress. He is under no legal obligation to do so. Of the four Presidents listed above who took office in January, each transmitted a revised budget to Congress. However, the extent of the revisions and the amount of detail provided has varied substantially—as suggested by the following summary.

President	*Submission*	*Scope*	*Date*
Nixon:	12-page memorandum.	Estimates for 1969 and 1970; reestimate of receipts postponed; no out-years; no current services.	April 15, 1969
Carter:	101-page compilation of Message and tables	Estimates for 1977 and 1978; no comparison with or use of current services baseline; disclaimer: "The 1978 budget is essentially still President Ford's budget, with only such limited revisions as my Administration has had time to make."	February 22, 1977
Reagan	"Program for Economic Recovery."	1981–86, program changes—but with line for "budget savings to be presented subsequently."	February 18, 1981
	"1982 Budget Revisions."	BA/outlays by function, 1980–82 (compared with Carter, not with current services)—but with "additional savings to be proposed."	March 21, 1981
	"1982 Budget Revisions, Additional Details or Budget Savings."	Proposed program changes (not all) with BA/outlays, 1981–86.	April 7, 1981

President	*Submission*	*Scope*	*Date*
Bush	"Remarks by the President to the Joint Session of Congress," 9 pages, with supplement entitled *Building a Better America*, 193 pages.	1989–93; proposed complete budget, including specific program initiatives (with outlays by function), reforms, natural declines, and special obligations.	February 9, 1989
	"General Explanation of the President's Budget Proposals Affecting Receipts," 55 pages.	In-depth discussion of 11 specific governmental receipt proposals, 1989–93.	February 9, 1989
	Supplementary data package provided to the Budget Committees, 28 pages.	Bridge from Reagan to Bush G-R-H baseline.	February 16, 1989
		FY 1990 Non-Defense Discretionary Residual Options, by Function/Subfunction.	
		Economic and technical changes since January, 1989–1993.	
		Adjustments for Credit Reform Component of Reagan Budget, 1989–1993.	
		Asset Sales Component of Reagan vs. Bush Budgets, 1989–1993.	
		Bush Structural Reforms vs. Current Services, 1989–1993.	
		National Defense Budget Levels, 1988–1993.	
	Supplementary data package provided to the Budget Committees, 491 pages.		February 18, 1989
	192 pages	FY 1990 Bush Budget Priority Programs by FY 90 BBA Category/Function/Subfunction/Account.	
	110 pages	FY 1990 Mandatory Residual Options by Function/Subfunction/Account.	
	4 pages	FY 1990 Defense Residual Options by Function/Subfunction/Account.	
	185 pages	FY 1990 Non-Defense Discretionary Residual Options by Function/Subfunction/Account.	
	"Testimony Before the House and Senate Budget Committees," 8 pages.	Explanations of both the President's priorities and how to pay for them.	February 21 and 22, 1989
	Appendices to the Testimony, 14 pages	Initial Presentations of Budget Data by New Presidential Administration—1969–1989	February 21 and 22, 1989
		Areas of Priority Initiative Spending.	
		Receipts Proposals and Priority Receipts Initiatives.	
		Mandatory Programs That Naturally Decline Under Current Law.	
		Structural Reforms in Mandatory Programs.	
		Applying the Residual Freeze.	
		Flows Associated With Financial Sector Reform.	

President	*Submission*	*Scope*	*Date*
Bush (Cont.):		Rescissions and Supplementals for Fiscal Year 1989.	
		Receipts, Outlays and Projected Deficits.	
		President Bush's Budget Presented in Budget Summit Framework.	
	Supplementary data package presented to the Appropriation Committees, 568 pages.		February 23, 1989
	188 pages	FY 1990 Bush Budget Priority Programs by Appropriation Subcommittee/Agency/Account.	
	380 pages	FY 1990 Residual Options by Appropriation Subcommittee/Agency/Account.	
	Supplementary data package presented to the Appropriations and Budget Committees and CBO, 1,298 pages.		March 3, 1989
	608 pages	FY 1990 Bush Priorities and Options for Residual Accounts by BBA (Bipartisan Budget Agreement) Category/Function/Subfunction/Account.	
	690 pages	FY 1990 Bush Priorities and Options for Residual Accounts by Function/Agency/Bureau/Account.	
	Supplementary data package presented to the Appropriations and Budget Committees and CBO, 1,676 pages.		March 6, 1989
	489 pages	FY 1990 February Current Services by Function/Agency/Bureau/Account.	
	565 pages	FY 1990 Bush Budget by Function/Subfunction/Account, 1989–1993.	
	622 pages	FY 1990 Bush Budget by BBA Category/Function/Subfunction/Account, 1989–1993.	

Appendix B

PRESIDENT BUSH'S BUDGET—AREAS OF PRIORITY INITIATIVE SPENDING

(In millions of dollars)

	1989		1990		Total Increase	
	BA	Outlays	BA	Outlays	BA	Outlays
Investing in R&D and Long-Term Productive Capacity						
Basic research	2,707	2,613	3,068	2,905	361	292
National Aeronautics and Space Administration	10,898	10,596	13,274	12,597	2,376	2,001
Superconducting Super Collider	100	100	250	206	150	106
National Institutes of Health	6,543	6,250	6,777	6,600	234	350
Census	655	672	1,497	1,587	842	915
Investing in People						
Department of Education	17,280	16,336	17,874	17,104	594	768
Ending the Scourge of Drugs						
Drug abuse	5,331	4,569	5,966	5,543	635	974
Prisons and other Justice Department programs	4,025	3,979	4,460	4,297	435	318
Meeting Special Obligations: A Kinder, Gentler America [1]						
Land and water conservation	206	240	206	244	—	4
Acid rain	190	92	710	120	520	28
Homeless:						
Fully fund the McKinney Act	466	408	746	496	280	88
Non-McKinney homeless initiative	—	—	50	25	50	25
Other assistance for homeless	125	92	211	124	86	32
Head Start	1,235	1,202	1,485	1,351	250	149
YES—Youth Engaged in Service	—	—	25	21	25	21
HIV/AIDS	1,287	1,217	1,600	1,377	313	160
Medicaid	34,301	34,301	37,616	37,616	3,315	3,315
Attending to Problems of the Past [2]						
Atomic energy clean up and modernization	2,588	2,536	3,663	3,237	1,075	701
Federal Aviation Administration	6,591	5,733	7,743	6,639	1,152	906
Securing a More Peaceful World						
International affairs	17,598	16,660	19,314	17,677	1,716	1,017
Total (excluding double counts)	111,631	107,239	125,974	119,234	14,343	11,995

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[1] Social security and means-tested entitlement programs are fully funded, but they are not reflected in this table.

[2] The comprehensive reform package (involving public and private resources) for FSLIC is described in Section III B–1 of *Building a Better America*.

Appendix C

PRESIDENT BUSH'S BUDGET—RECEIPTS PROPOSALS

(In millions of dollars)

	1990	1991	1992	1993
Governmental Receipts				
Double and restore adoption deduction	–*	–3	–3	–3
Eliminate Superfund tax differentials	0	0	0	0
Enhance long-term investment incentives	4,800	4,900	3,500	2,200
Establish credit for intangible drilling	–200	–300	–300	–400
Establish enterprise zones	–150	–200	–300	–400
Establish user fee on IRS telephone services	—	48	48	48
Expand and extend the child care credit:				
Establish a new tax credit and revise existing credit—receipt effect	–5	–46	–48	–52
Make existing and proposed credit refundable—outlay effect	–182	–1,847	–2,163	–2,430
Subtotal, child care	–187	–1,893	–2,211	–2,482
Extend Customs processing fee	—	157	167	177
Extend HI coverage to State and local employees[1]	1,831	1,915	1,916	1,906
Extend R&E credit	–387	–688	–963	–1,150
Extend telephone excise tax[1,2]	—	1,586	2,606	2,804
Increase NRC and FEMA fees	341	352	353	360
Increase IRS enforcement	317	630	653	668
Let abandoned mine fee expire	—	—	–44	–269
Make miscellaneous changes in receipts[3]	–23	–10	–2	8
Provide credit for tertiary enhanced recovery	–*	–*	–*	–*
Reduce customs fees to be GATT competitive	–197	–243	–291	–310
Repeal airport and airway trigger[1]	892	1,553	1,678	1,805
Revise AMT for exploratory drilling by independents	–100	–100	–100	–100
Revise oil and gas depletion rules	–39	–49	–45	–47

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[1] Net of income tax offsets.

[2] Assumes extending the current tax of 3 percent.

[3] Includes initiation of Federal marine fishing licenses and fees, an increase in the D.C. employer contribution to the civil service retirement system, the receipt impact of the Federal pay raise, and other small items outside the jurisdiction of the Finance Committee.

PRESIDENT BUSH'S BUDGET—RECEIPTS PROPOSALS—Continued

(In millions of dollars)

	1990	1991	1992	1993
Revise R&E allocation rules	-1,699	-749	-814	-887
Revise unemployment tax on Amtrak	-5	-2	3	4
Receipt effect	6,147	9,602	8,950	7,355
Outlay effect	-953	-2,698	-3,099	-3,423
Total, Bush proposals	5,194	6,904	5,851	3,932
User Fees				
Loan guarantee fees:				
Small Business Administration	94	94	94	94
Commodity Credit Corporation export loans	30	30	30	30
Rural Electrification Administration	14	27	41	55
Farmers Home Administration	3	30	49	62
Subtotal, loan guarantee fees	141	181	214	241
Federal and federally-sponsored enterprise fees:				
Government-sponsored enterprises (GSEs):				
Freddie Mac	25	101	236	321
Fannie Mae	30	120	274	371
Sallie Mae	4	19	45	63
Connie Lee[4]	n.a.	n.a.	n.a.	n.a.
Subtotal, GSE fees	59	240	555	755
Government National Mortgage Association (Ginnie Mae) fees	0	23	75	128
Subtotal, GSE and Ginnie Mae	59	263	630	883
Total, credit fees	200	444	844	1,124
Service fees:				
Coast Guard: decal for recreational and commercial boaters	180	180	180	180
Food and Drug Administration	87	97	101	103
Animal and plant health inspection	68	68	68	68
Veterans medical care	24	26	27	29
Corps of Engineers recreational facilities	20	21	23	24
U.S. Travel and Tourism Administration	11	13	15	15

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[4] Data not available; only relatively small amounts anticipated.

PRESIDENT BUSH'S BUDGET—RECEIPTS PROPOSALS—Continued

(In millions of dollars)

	1990	1991	1992	1993
User Fees—Continued:				
Service fees—continued:				
Railroad safety	9	15	31	31
Forest service	8	8	8	8
National Oceanic and Atmospheric: maps, charts, and data sales	7	7	7	10
Agriculture marketing service	4	4	4	4
Small Business Administration	3	3	3	3
Total, service fees	421	442	467	474
Total, all user fees	620	886	1,311	1,598
Other Offsetting Collections				
Outer Continental Shelf receipts	10	0	−136	0
Arctic National Wildlife Refuge	2,101	1	1	1,301
Chlorofluorocarbon production rights	400	1,350	550	625
Unassigned spectrum, FCC	2,252	1,126	0	0
Subtotal, other collections	4,763	2,477	415	1,926
Total receipts and collections	10,577	10,267	7,577	7,456

Appendix D

PRESIDENT BUSH'S BUDGET—MANDATORY PROGRAMS THAT NATURALLY DECLINE UNDER CURRENT LAW

(In millions of dollars)

	Current Services		
	1989	1990	Decrease
International affairs:			
Development and humanitarian aid, offsetting receipts	-480	-505	-25
Conduct of foreign affairs	15	9	-6
International financial, excluding Export-Import Bank	-68	-81	-13
Energy:			
Tennessee Valley Authority	540	300	-240
Nuclear waste disposal fund	-526	-538	-12
Nonconventional fuel	159	4	-155
Agriculture:			
Commodity Credit Corporation	13,036	12,645	-391
Crop insurance fund	1,049	356	-693
Commerce and housing credit:			
Ginnie Mae mortgage-backed securities	-210	-313	-103
Federal Housing Administration, excluding asset sales	1,537	586	-951
Federal Deposit Insurance Corporation	3,807	-1,324	-5,131
National Credit Union Administration	-169	-195	-26
Science and technology	189	152	-37
Transportation:			
Panama Canal fund	34	-4	-38
Education, training, employment, and social services:			
Guaranteed student loans	3,602	3,282	-320
Income security:			
Means-tested:			
Aid to Puerto Rico	908	825	-83
Supplemental Security Income	11,389	11,038	-351
Family support	9,847	9,581	-266
Earned Income Tax Credit	3,849	3,841	-8
Other:			
Disabled coal miners	1,529	1,505	-24
Pension Benefit Guaranty Corporation	-301	-415	-114
Federal employee life insurance	-782	-842	-60
Low-rent public housing loans	788	503	-285
Veterans benefits and services:			
GI bill and readjustment benefits	620	451	-169
Third-party reimbursement	-138	-304	-166
Loan guaranty fund, excluding fees and asset sales	1,758	1,582	-176
Administration of justice:			
Customs fee	-637	-771	-134
General government:			
OPM revolving fund	-11	-25	-14
Mineral and land payments	547	511	-36
Total	51,881	41,854	-10,027

Appendix E

PRESIDENT BUSH'S BUDGET—STRUCTURAL REFORMS IN MANDATORY PROGRAMS

(Outlays in billions of dollars)

	1989	1990	Dollar Change
Medicare	84.5	92.5	+8.0
Federal Employees Health Benefits	1.9	1.6	–0.3
Farm Support Payments	13.9	10.7	–3.2
Power Marketing Reforms	–0.6	–1.5	–0.9
Lump-Sum Federal Retirement Benefits	1.6	0.6	–1.0
Other [1]	2.9	2.0	–0.9
Total	104.2	105.9	+1.6

	1990	1991	1992	1993
Savings from Current Law:				
Medicare	–5.0	–8.1	–10.7	–13.6
Federal Employees Health Benefits	–1.2	–1.5	–1.8	–2.0
Farm Support Payments	–1.9	–1.8	–2.4	–2.4
Power Marketing Reforms	–0.9	–0.6	–0.5	–0.5
Lump-Sum Federal Retirement Benefits	–2.1	–2.2	–2.4	–2.5
Other [1]	–0.6	–0.2	–0.2	–0.4
Total	–11.8	–14.4	–18.0	–21.3

[1] Other includes a 1990 adjustment for electronic transfers of food stamp cash balances, reform of guaranteed student loans, and extensions of a 1 percent VA loan fee and VA asset sales.

Appendix F

PRESIDENT BUSH'S BUDGET—APPLYING THE RESIDUAL FREEZE

(Outlays in billions of dollars)

	1989	1990	Dollar Change	Percent Change
Freeze residual non-defense spending at 1989 levels ("nominal freeze") [1]	136.0	136.0	—	—
Freeze Federal retirement COLAs	51.2	52.7	1.5	2.9
Freeze defense budget authority at zero real growth [2]	289.8	291.2	1.4	0.5
Total	477.0	479.9	2.9	0.6

[1] This nominal freeze applies to all programs except social security and other social insurance program benefits, means-tested entitlement benefits, programs subject to structural reforms, mandatory programs that decline naturally, initiatives (including S&L reform) specified in the Bush budget, net interest, undistributed offsetting receipts, and asset sales.

[2] The defense freeze is applied to budget authority for subfunction 051. Numbers presented above are the associated outlays.

Appendix G

PRESIDENT BUSH'S BUDGET—FLOWS ASSOCIATED WITH FINANCIAL SECTOR REFORM

(In billions of dollars)

	1989	1990	1991	1992	1993	1989–1999
FSLIC and RTC Account						
Disbursements:						
Old cases and other expenses:						
Administrative and miscellaneous	0.3	0.3	0.3	0.3	0.3	2.8
Notes issued	9.7	—	—	—	—	9.7
Interest on notes outstanding	1.4	1.5	1.1	0.9	0.8	9.2
Repayment of notes issued prior to 1987	—	—	0.2	—	0.2	0.5
Assistance payments	5.2	4.4	3.8	4.2	3.4	28.8
Liquidations	1.0	—	—	—	—	1.0
Total, old cases and other expenses	17.7	6.2	5.5	5.4	4.7	52.2
New cases:						
Assisted mergers	5.0	12.5	8.5	1.2	1.8	44.0
Liquidations	5.0	12.5	8.5	1.2	1.8	30.0
Total, new cases	10.0	25.0	17.0	2.4	3.6	74.0
Total disbursements	27.7	31.2	22.5	7.8	8.3	126.2
Collections (–):						
FICO proceeds (CEBA) (–)	–3.8	–3.3	—	—	—	–7.1
New REFCORP proceeds (–)	–10.0	–25.0	–15.0	—	—	–50.0
Insurance premiums:						
Before deductions (–)	–2.1	–2.3	–2.7	–2.9	–3.1	–31.6
Deduct (+):						
FICO (CEBA) interest	0.6	0.9	1.0	1.0	1.0	10.7
Secondary reserve credit	0.1	0.1	0.1	0.1	0.3	0.7
Defense new bond principal	—	1.7	1.7	—	—	3.3
Net premium income (–)	–1.4	0.4	0.1	–1.8	–1.7	–16.9
Procceds from receivers and corporate-held assets (old cases) (–)	–1.4	–1.4	–1.2	–1.0	–1.4	–9.7
Income on investment balances (–)	–0.1	—	—	—	–0.1	–1.1
Other collections (–)	–0.4	–0.4	–0.4	–0.3	–0.3	–3.5
Total collections	–17.0	–29.8	–16.5	–3.2	–3.6	–88.3
FSLIC/RTC net outlays	10.7	1.4	6.0	4.6	4.7	37.9
Repayments of notes issued after 1986	0.4	0.3	0.1	—	1.1	19.2
Balance of FSLIC notes outstanding (end-of-year)	19.2	18.9	18.6	18.5	17.3	—
FSLIC/RTC cash/investment end-of-year balances (9/30/88 = $1.9 billion):						
Balance for cases	0.6	0.5	0.5	0.5	0.5	0.5
Balance for new fund	—	—	—	1.0	2.1	8.8
Summary of Accounts Affected						
FSLIC net outlays	10.7	1.4	6.0	4.6	4.7	37.9
Treasury contribution to REFCORP interest	0.5	1.4	1.6	0.9	0.8	22.0
Additional FDIC collections	—	–0.8	–1.6	–1.7	–1.8	–19.9
Total budget outlays	11.1	1.9	6.0	3.8	3.7	39.9

Appendix H

PRESIDENT BUSH'S BUDGET—RESCISSIONS AND SUPPLEMENTALS FOR FISCAL YEAR 1989 [1]

(In billions of dollars)

	Budget authority	Outlays	Revenues	Deficit
Rescissions [2]	*	*	—	*
Mandatory supplementals:				
Guaranteed student loans (pending from January)	—	0.3	—	0.3
Guaranteed student loans (change for economics)	—	0.4	—	0.4
VA compensation, pensions, and burial benefits	0.7	0.7	—	0.7
VA readjustment benefits	*	*	—	*
VA loan guaranty	0.3	0.3	—	0.3
TAA training and benefits	0.1	0.1	—	0.1
Other Supplementals: [3]				
Forest Service firefighting	0.3	—	—	—
Student financial assistance	*	—	—	—
Foster care/adoption assistance [4]	0.4	0.4	—	0.4
Justice (FSLIC)	*	*	—	*
Total supplementals	1.8	2.2	—	2.2
Other changes:				
Administrative actions:				
Advanced deficiency payments	—	0.8	—	0.8
Strategic petroleum reserve	—	0.1	—	0.1
Substantive legislation:				
Guaranteed student loans	—	-*	—	-*
Capital gains tax reduction	—	—	0.7	-0.7
FSLIC	—	0.4	—	0.4
Amtrak unemployment insurance tax	—	—	-*	-*
Treaty ratification:				
Compact of free association	0.2	0.2	—	0.2
Related debt service	*	*	—	*
Grand total	2.6	3.7	0.7	3.0

* Less than $50 million.

[1] As of February 9, 1989.

[2] President Reagan's rescission proposals are withdrawn except for those that offset proposed spending increases.

[3] Excludes supplementals that are entirely offsetting.

[4] Foster care/adoption assistance figures were not included in published numbers. All other supplementals were included.

Appendix I

PRESIDENT BUSH'S BUDGET—RECEIPTS, OUTLAYS, AND PROJECTED DEFICITS

(Assuming Prompt Implementation of the President's Proposals)

(In billions of dollars)

	1989	1990	1991	1992	1993
Receipts	979.3	1,065.6	1,147.6	1,218.6	1,286.6
Outlays, excluding asset sales	1,149.9	1,160.4	1,211.8	1,249.2	1,284.1
Deficit, excluding asset sales.	170.7	94.8	64.2	30.6	–2.5
G-R-H targets	136.0	100.0	64.0	28.0	0.0
Deficit, including asset sales[1]	163.7	91.1	61.9	26.8	–3.8

[1] The 1989 amount is $0.4 billion higher than the February 9 estimate to adjust for all supplementals—including foster care/adoption assistance, which was omitted in the February 9 calculation.

Appendix J

PRESIDENT BUSH'S BUDGET—PRESENTED IN BUDGET SUMMIT FRAMEWORK

(In billions of dollars)

	1989 February Estimate	1990 Bush Budget	1990 Bush vs. 1989 Est.
Defense:			
Priority:			
Department of Defense:			
Budget Authority	290.2	299.3	+9.1
Outlays	289.8	291.2	+1.4
Atomic energy cleanup:			
Budget Authority	2.6	3.7	+1.1
Outlays	2.5	3.2	+0.7
Other:			
Budget Authority	6.0	6.0	—
Outlays	5.9	5.9	—
Total:			
Budget Authority	298.8	309.0	+10.2
Outlays	298.3	300.4	+2.1
International Discretionary:			
Priority:			
Budget Authority	17.6	19.3	+1.7
Outlays	16.7	17.7	+1.0
Freeze:			
Budget Authority:			
Option 1 (RR method)	0.7	0.1	–0.6
Option 2 (nominal outlays [a])	0.7	0.7	—
Outlays	–0.3	–0.3	—
Total:			
Budget Authority:			
Option 1 (RR method)	18.3	19.4	+1.1
Option 2 (nominal outlays [a])	18.3	20.0	+1.7
Outlays	16.3	17.3	+1.0
Domestic Discretionary:			
Priority:			
Budget Authority	47.5	55.5	+8.0
Outlays	56.9	62.1	+5.2
Freeze:			
Budget Authority:			
Option 1 (RR method)	95.9	91.3	–4.6
Option 2 (nominal outlays [a])	95.9	94.1	–1.8
Outlays	120.2	120.2	—
Total:			
Budget Authority:			
Option 1 (RR method)	143.4	146.8	+3.5
Option 2 (nominal outlays [a])	143.4	149.5	+6.2
Outlays	177.1	182.4	+5.2

PRESIDENT BUSH'S BUDGET—PRESENTED IN BUDGET SUMMIT FRAMEWORK—Continued

(In billions of dollars)

	1989 February Estimate	1990 Bush Budget	1990 Bush vs. 1989 Est.
Mandatory:			
Naturally Declining:			
Outlays	51.9	41.9	−10.0
Structural Reform:[b]			
Outlays	104.2	105.9	+1.6
Freeze:			
Outlays	10.2	10.2	—
Other:			
Outlays	377.1	387.3	+10.2
Total (excluding double counts):			
Outlays	526.4	529.1	+2.7
Asset Sales and Prepayments:			
Budget Authority	−0.9	−1.4	−0.5
Outlays	−6.9	−3.6	+3.3
User Fees and Other Collections:			
Budget Authority	—	−5.2	−5.2
Outlays	—	−5.2	−5.2
Interest:			
Budget Authority	168.8	173.3	+4.5
Outlays	168.8	173.3	+4.5
Undistributed Offsetting Receipts:			
Budget Authority	−36.9	−36.9	—
Outlays	−36.9	−36.9	—
Total:			
Outlays	1,143.0	1,156.8	+13.8
Receipts	979.3	1,065.6	+86.4
Deficit	163.7	91.1	−72.6

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[a] Freeze option 2 is a nominal outlay freeze at the account level.

[b] Includes portions of GSL and farm support payments counted in "Naturally Declining," and FEHB and PMA reform counted in "Domestic Discretionary—Priority."

Appendix K

PRESIDENT BUSH'S BUDGET—PRIORITY SPENDING PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON FINANCE

(Outlays in billions of dollars)

	1989	1990	1991	1992	1993
Program: [1]					
Social Security (OASDI) benefits	230.0	244.3	259.9	274.5	288.2
SSI benefits	11.4	11.0	12.7	13.3	13.9
Unemployment insurance benefits	13.8	14.3	14.4	15.3	16.1
AFDC benefits and child support	9.8	9.6	9.6	10.0	10.8
Trade adjustment Assistance benefits	0.3	0.2	0.2	0.2	0.2
Medicare benefits [2]	84.6	92.5	104.3	118.0	129.2
Medicaid benefits	34.3	37.6	41.7	45.8	49.8
Adoption Initiative in Foster Care account [3]	0.1	0.1	0.1	0.1	0.2

[1] The estimates in this table are for benefits only. Administrative costs are in the "residual freeze" category of the Bush Budget.

[2] Medicare change from current services

	1989	1990	1991	1992	1993
Medicare change from current services	—	–5.0	–8.1	–10.7	–13.6

[3] Excludes 1989 supplemental of $0.4 billion.

Appendix L

PRESIDENT BUSH'S BUDGET—SPENDING PROPOSALS IN THE "RESIDUAL FREEZE" CATEGORY WITHIN THE JURISDICTION OF THE COMMITTEE ON FINANCE

(Outlays in millions of dollars)

	1989 Budget February Estimate	1990 Freeze Option 1 RR Method	1990 Freeze Option 2 Nominal Freeze	1990 Freeze Option 3 (To Be Negotiated)
Foster care	928	787	928	
TAA training	80	49	80	
Administrative expenses:				
Social Security (OASDI)	2,342	2,420	2,342	
SSI	1,087	1,111	1,087	
Medicare	2,269	2,428	2,269	
AFDC (State administered)	1,475	1,476	1,475	
Unemployment insurance	1,675	1,744	1,675	

Appendix M

PRESIDENT BUSH'S BUDGET—TOTAL RECEIPTS

(In billions of dollars)

	1989	1990	1991	1992	1993
Individual and corporation income taxes	534.5	589.9	642.9	689.6	728.1
Social insurance taxes and contributions:					
Employment taxes and contributions:					
Off-budget	267.5	289.2	312.8	332.1	354.8
On-budget	69.3	75.6	80.9	85.6	91.0
Subtotal, employment taxes	336.8	364.8	393.7	417.7	445.8
Unemployment insurance receipts	23.1	22.4	20.9	19.9	19.8
Contributions for other insurance and retirement	4.7	4.7	4.8	4.8	4.7
Subtotal, social insurance taxes and contributions:					
Off-budget	267.5	289.2	312.8	332.1	354.8
On-budget	97.2	102.7	106.6	110.2	115.6
Total	364.7	391.9	419.4	442.3	470.3
Excise taxes	34.0	35.3	35.8	36.6	37.4
Estate and gift taxes	7.8	8.1	8.3	8.3	8.3
Customs duties and fees	16.3	17.4	18.6	19.5	20.2
Miscellaneous receipts:					
Federal reserve deposits	18.5	19.2	18.9	18.3	18.4
Other miscellaneous	3.4	3.7	3.8	4.0	3.8
Subtotal, miscellaneous	21.9	23.0	22.7	22.3	22.2
Receipts:					
On-budget	711.8	776.4	834.8	886.5	931.8
Off-budget	267.5	289.2	312.8	332.1	354.8
Total	979.3	1,065.6	1,147.6	1,218.6	1,286.6

Appendix N

PRESIDENT BUSH'S BUDGET—MEDICARE: PROPOSED "SAVINGS" RELATIVE TO "CURRENT SERVICES" [1]

(Outlays in millions of dollars, net of offsetting receipts)

	1990	1991	1992	1993
Medicare Current Services	99,977	115,238	131,611	145,702
Extensions of Current Provisions				
Capital at 85% of Cost Allocation	930	1,190	1,300	1,420
25% Floor on Part B Premiums	714	1,757	2,812	4,409
Clinical Lab Limits	190	330	410	480
Continue Current Provisions	1,834	3,277	4,522	6,309
Further Restraint on Cost Growth				
Part A Proposals:				
Capital at 75% of Cost Allocation	620	780	880	940
Reduce Indirect Medical Education to 4.05%	1,020	1,290	1,410	1,540
Reduce Part A Graduate Medical Education Overhead	120	130	135	140
Update PPS Rates by Hospital Inflation minus 1.5%	625	800	875	955
Other Part A Proposals	10	21	23	25
Subtotal, Part A Proposals	2,395	3,021	3,323	3,600
Part B Proposals:				
Freeze Non-Primary Physician Prevailing Charges	375	960	1,640	2,085
Reduce Radiology, Anesthesia, and Surgical Payments by 8%	250	430	510	570
Reduce Payments for Overpriced Procedures	100	180	210	240
Target Physician Reforms	70	155	210	255
Limit Outpatient Department Reimbursements	0	220	520	780
Reform Durable Medical Equipment Payments	160	240	290	330
Eliminate Home Kidney Dialysis Loophole	50	100	150	230
Reduce Part B Graduate Medical Education Overhead	30	30	35	40
Impact on Part B Premiums	−295	−612	−876	−1,076
Subtotal, Part B Proposals	739	1,703	2,689	3,454
Interaction—Catastrophic Health Insurance	90	160	200	250
Total	5,058	8,161	10,734	13,613

NOTE: The budget also reproposes one Part A revenue proposal. Under current law, all State and local employees hired after March 31, 1986 are covered by HI. This proposal would extend coverage to all State and local employees and generates revenues of $1.8 billion in FY 1990.

[1] HCFA actuary estimates.

QUESTION SUBMITTED BY SENATOR BENTSEN

Question. Mr. Darman, I understand why you may want to stick with the dollar amount in the budget as your best estimate of what is needed for full funding, but would you support deleting the Reagan legislative language that undermines the entitlement nature of the account, and using instead the same language that typically applies to the cash welfare program (AFDC), and that allows States to draw down the full amount of their entitlement, if there are unanticipated needs that exceed the dollar amount specified in the annual appropriation?

Answer. The language should indicate that the account is an entitlement, however it should be for this purpose capped at the current reasonable estimate. If actual program costs exceed the amount appropriated, then a supplemental would be needed.

QUESTIONS SUBMITTED BY SENATOR MOYNIHAN

MEDICARE REDUCTIONS

Mr. Darman: At the confirmation hearings for Dr. Sullivan, I submitted questions concerning proposed reductions in Medicare capital payments and the indirect medical education (IME) adjustment to hospitals. Prior to 1981, these questions would have been the primary responsibility of the Secretary of Health and Human Services. However, during the Reagan administration the Office of Management and Budget (OMB) became the driving force, the ultimate decision maker, in reducing health care expenditures. I recognize that the policy expertise on these matters rests with the Secretary of HHS; however, based on past experience, I am very interested in your response to these questions.

Hospital Capital: The recent cuts in Medicare capital payments are based on the assumption that hospital occupancy rates across the country are very low (60%) and that Medicare should not reimburse hospitals for empty beds. It is also based on the assumption that hospitals face few restrictions on how and when to undertake capital expenditures. However, in New York the occupancy rate averages over 90 percent statewide (for some hospitals over 100%), and the State maintains tough Certificate of Need rules (requirements needed before any construction can take place).

Question. How will Medicare address the capital concerns of States like New York?

Answer. Hospital capital will be paid prospectively beginning October 1, 1991 under current law. Under prospective payment, where capital payments are linked by Diagnosis-Related Groups to discharges, the capital requirements of States with high occupancy rates will be recognized. Hospitals with a high volume of discharges will receive proportionately more capital payments than those with fewer discharges, other factors being equal.

By 1991, hospitals will have begun planning for prospective capital payments, relying on the requirements in statute. The long lead times associated with hospitals' capital planning processes, and the associated adjustments by financial markets make timely publication of a detailed rule desirable.

Medical Education: Some studies show large teaching hospitals doing well under the Medicare prospective payment system (PPS). However, more studies show many large teaching hospitals losing money.

Question. How can we reconcile cuts in payments for medical education with the fact that these hospitals get the sickest patients and in some cases, they provide the only health care available to the poor?

Answer. Data collected and presented by the Congressional Prospective Payment Commission (ProPAC) indicate that teaching hospitals fare extremely well under Medicare's Prospective Payment System (PPS) ProPAC's June 1988 report to Congress titled *Medicare Prospective Payment and the American Health Care System* concludes that large teaching hospitals enjoyed an average Medicare operating margin of 11 percent in the third year of PPS, and that no teaching hospital had a negative Medicare operating margin in any of the first three years of PPS.

The President's proposal to adjust the indirect medical education (IME) add-on payments from 7.7% to 4.05% is consistent with analyses by the Prospective Payment Commission and the General Accounting Office (GAO) In a recent report to the Secretary of Health and Human Services, ProPAC recommended a rate of 4.4%, phased in over three years; GAO, in a report to Congress, concluded that a 5.09% rate is appropriate.

In addition to their IME adjustment, teaching hospitals treating sicker-than-average patients who incur high costs or require long lengths of stay are compensated for these "outlier" cases by Medicare. Finally, hospitals treating a disproportionate share of lower income patients are eligible for additional Medicare payments.

AIDS FUNDING

Mr. Darman: President Bush proposes Medicaid funding at the current services level for FY 90.

Question. Does the Bush budget proposal assume increases in Medicaid expenditures due to AIDS? If so, what are these assumptions?

Answer. The HCFA Medicaid Actuary has estimated that $1.3 billion will be spent in the joint State/Federal Medicaid program on behalf of AIDS victims in FY 1990.

HCFA's Medicaid budget does not contain an elicit line item for any particular medical diagnosis. Instead, the States report their expenditure estimates by service category, such as inpatient hospital, nursing home, or drug expenditures.

As you know, my own State of New York has been disproportionately burdened by the AIDS epidemic. This situation will only worsen as more and more I.V. drug abusers spread the deadly virus to their sexual partners and children. The Medicaid system in New York, already sorely taxed, will be strained even further. New York State will need to find innovative ways to treat the growing population of poor AIDS patients throughout the State.

During the Reagan administration, OMB played an important role in the Medicaid waiver process, often impeding that process.

Question. What role will the Office of Management and Budget play in the Medicaid waiver process? What will you do as Director to expedite the waiver process?

Answer. Most waivers for AIDS patients are under section 1915(c) of Title XIX of the Social Security Act which authorize the State to provide home and community based services to a target population as a substitute for more costly institutional services. The OMB does not participate in the review process for these waivers. Other waivers affecting AIDS patients might include those for research or demonstration purposes. HHS advises the OMB of the costs associated with research and demonstration waivers having significant budget implications within 30 days prior to approval. OMB staff responds to any requests for information or advice as expeditiously as possible.

Mr. Chairman, I would ask that two articles, one from the *New York Times* entitled "AIDS Patients Seen Straining Hospitals" and one from the *Washington Post* entitled "New York Hospitals Becoming Overextended" be printed in the hearing record. These articles succinctly illustrate the dire situation facing the health care system in New York State because of AIDS, a situation that I trust Mr. Darman, and also, members of this committee will keep uppermost in their minds as we debate changes in the Medicaid and Medicare systems in the coming year.

PROPOSALS TO CUT REIMBURSEMENTS FOR MEDICAID ADMINISTRATIVE COSTS

Mr. Darman: Last year, Congress passed, and President Reagan signed, two historic measures: first, the Medicare Catastrophic Coverage Act, the most significant expansion in the Medicare program since its inception; second, the Family Support Act, our monumental overhaul of the Nation's welfare system.

Both of these measures expand the Medicaid program significantly. The Medicare Catastrophic Coverage Act mandates Medicaid coverage to pregnant women and infants below the poverty line. It also mandates that States pay for Medicare premiums, copayments and deductibles for poor elderly citizens below 100 percent of poverty.

The Family Support Act mandates that States continue Medicaid coverage for one full year after a welfare mother works her way off the rolls.

Question. Could you please explain for the committee the Medicaid administrative cuts contained in the Bush budget proposal?

Answer. The administration proposes to phase down special matching rates for certain administrative costs, in order to help offset the cost of expanded coverage for low-income pregnant women, infants, and children. These special matching rates were meant to foster the early development of the Medicaid program and are no longer necessary. The Federal government would eventually pay the standard administrative matching rate of 50 percent.

Special matching rates for State Medicaid fraud control units would be unchanged. The special matching rates recently enacted by OBRA-87 for survey and certification of nursing homes and preadmission screening and resident review activities would not be phased out until FY 1995.

Question. Given the added Medicaid administrative responsibilities placed on the States due to the Medicare Catastrophic Coverage and Family Support Acts, why is the administration proposing cuts in the Medicaid matching rates for administrative costs?

Answer. The administration proposes no change in matching rates for administrative costs associated with the Medicare Catastrophic Coverage and Family Support Acts. The standard matching rate for general administrative costs would remain at 50 percent. The Federal government will continue to share equally in State administrative costs with the States.

Enhanced matching rates for certain special administrative costs would be phased down to 50 percent, in order to help offset the cost of expanded coverage of low-income pregnant women, infants, and children. These special matching rates were intended to foster the early development of the Medicaid program and are no longer necessary. Since Medicaid is a joint Federal/State program, a 50:50 split of States' administrative costs is a balanced financial arrangement.

The special matching rates recently enacted by OBRA-87 provisions on nursing homes would not be phased out until FY 1995. Enhanced matching rates for State Medicaid fraud control units would be unchanged.

JOBS PROGRAM

Question. As you know, the final Reagan Budget for FY90 proposes to reduce the capped entitlement funding for the JOBS program from the $800 million specified in the Family Support Act to a maximum of only $350 million. The Bush Budget is silent on this issue. Please explain for this committee the Bush administration's position on funding for the JOBS program.

Answer. Funding for WIN/JOBS is included in the residual category, subject to negotiation with Congress. Using the Reagan Budget as a starting point for the budget process, WIN and JOBS are combined and funded at the best current estimate of FY90 JOBS/WIN costs—$350 million. The language should indicate that the account is an entitlement, however it is for this purpose capped at the current reasonable estimate. If actual program costs exceed the amount appropriated, then a supplemental would be needed.

QUESTIONS SUBMITTED BY SENATOR HEINZ

Question. There is a growing and strong consensus that Medicare simply cannot withstand another $5 million in cuts this next year. Hospitals are nearing the end of their financial ropes and we may not be far enough along in our work in physician payment reform to safely garner savings of that magnitude. Given these facts, which of the Bush savings proposals would you choose to drop or modify to bring the total savings target down to, say, the G-R-H sequester level of $1.2 billion?

Answer. There is an obvious need to get our fiscal deficit down. This is not a partisan matter. It is a matter of practical necessity. If we do not get the deficit down, there will be a regrettable price to be paid—in human terms—by both young and old, both the current generation and future generations. Medicare is not only a large portion of the budget, it is also one of the most rapidly growing portions. The growth of Medicare must be restrained in any balanced approach to restraint on Federal spending growth. Failing to restrain this growth will deprive other worthy programs. Under the President's proposals, which would moderate the increase in spending from FY 1989 to FY 1990, Medicare would still increase by $8 billion. Simply extending three current law provisions keeping today's rules in place next year—would save $1.8 billion. Another $3.2 billion in savings could be achieved through hospital and physician payment reforms, with no adverse impact on beneficiaries. Extending the current law 25% SMI premium requirement and gaining control over explosive increases in physician costs are two key priorities.

Question. The President's budget makes no distinction in the updates of urban and rural hospitals. How do you justify this in light of the fact that rural hospitals have been disproportionately hurt under PPS and that half of the 81 hospitals that closed last year were in rural areas?

Answer. Rural hospitals, which account for about half of Medicare prospective payment system (PPS) hospitals, have been treated favorably in each of the past two years. OBRA '86 created a separate pool from which to provide assistance to rural hospitals' high-cost or long-length-of-stay patients (outliers), excluded sole community hospitals from reductions in capital payments, made several expansionary adjustments in the eligibility criteria for rural referral centers and rural disproportionate share hospitals, and increased the pool of funds available to rural hospitals by switching to case-weighted averages to determine costs.

OBRA '87 provided rural hospitals with an FY 1988 PPS rate increase higher than urban hospitals, and made numerous other changes to benefit rural hospitals and clinics.

For FY 1989, OBRA '87 also provided rurals a preferential PPS update. Current law requires identical rural- urban updates in FY 1990, thereby preserving the differential for another year. The President's budget, consistent with current law, proposes a single PPS update for all hospitals.

Question. Paul Ginsburg, Chairman of the Physician Payment Review Commission, testified before the Senate Budget Committee that the only solution to controlling Medicare spending is the implementation of the so called "effectiveness initiative." What is OMB's commitment to this effort, what level of spending for research and development of practice guidelines are proposed for FY 1990 and what can we expect in the way of savings from this initiative in FY 1990 and outyears?

Answer. The administration is supportive of the wide range of public and private efforts now underway to assess the effectiveness and appropriateness of medical procedures and technologies. Within the Department of Health and Human Services, the Office of the Assistant Secretary for Health (OASH), the Public Health Service (PHS), the National Center for Health Sciences Research (NCHSR), and the Health Care Financing Administration (HCFA) will be working closely with the medical professions and the health research community on what will be an ongoing research effort to improve the quality and affordability of health care. We anticipate that private payors, universities, medical specialty societies, and the research community will continue to take the lead for much of this research and in developing practice guidelines.

The Reagan administration FY 1990 Budget proposed $50 million in a new separate Medical Treatment Effectiveness account within OASH. While the precise level of FY 1990 Federal financial support for outcomes research, data collection and management, consensus development, and dissemination is subject to negotiation with the Congress, the Bush administration shares the Commission's hope that effectiveness research will provide positive, long-range benefits. Since effectiveness or patient outcomes research is still in its infancy, it would be premature to price or score savings now from future research findings.

PREPARED STATEMENT OF SENATOR DAVE DURENBERGER

Mr. Chairman, I do not want to take too much of the committee's time in my opening statement because I think that everyone knows where I stand on the issue of how many further reductions the Medicare program can take without jeopardizing the quality of care available to the 35 million people who depend on Medicare for their health care services.

This country is in desperate need of a program to balance its budget. Every year of delay in facing this problem head-on, means that our children will just have to pay a larger cost in higher future taxes our reduced future services. I am willing to consider any number of solutions to our budget dilemma. But I am not willing to allow for across-the-board cuts in essential services, especially Medicare services, which will only reduce the quality of available medical services, especially services provided in rural America.

Over the past seven years Medicare has given more than its fair share in the battle to reduce the deficit. In fact, payment reductions to hospitals over the past 7 years have amounted to nearly $54 billion. And while these reductions have made it difficult for many urban hospitals to survive, these cuts have made it *impossible* for many rural hospitals throughout the country to stay in business.

Just in the last year five rural hospitals closed in my State alone, while a total of 78 closed throughout the country. As I am sure the Chairman knows, there are hundreds of hospitals in rural America that are teetering on the verge of insolvency. I am certain that unless we provide a greater sense of equity and fairness in the reimbursement system for these hospitals, many more will be closing in the next twelve months. I will do everything to prevent that from happening.

Mr. chairman, the country faces a crisis in the savings and loan industry that could ultimately cost the taxpayers of this country more than $100 billion to resolve. Yet we are committed to finding Federal taxpayer money for bailing out this industry which has engaged in practices which in many worst cases can only be labeled criminal, and in the best cases questionable. At the same time, there are hundreds of marginal hospitals in rural America, who through no fault of their own, are operating on the margin of solvency. In my view, it would be unconscionable for us to allow these hospitals to fail because the Federal government cannot find the financial resources to reimburse them for providing services to the elderly people they serve in their community.

Mr. Chairman, I look forward to working with you to ensure that that will not happen.

Prepared Statement of Senator John Heinz

I commend you, Mr. Chairman, for convening this hearing on the underlying economic assumptions contained in the President's budget for FY90 and the proposed spending cuts over which this committee has jurisdiction. Rather than address the full range of issues to be covered in today's hearing, I want to briefly comment on the President's proposed spending levels for Medicare—an area of particular concern to this committee, to my constituents, and to me personally.

For nearly a decade, the Congress has attempted to rein-in escalating health care costs and to contribute to deficit reduction by constraining growth in Medicare spending. We did this in ways we believed were equitable and would ensure the beneficiary's continued access to high quality care. We are now seeing the returns on our sustained cost containment efforts—and they are mixed.

Legislative reforms in hospital, physician and other provider payments since 1982 have provided nearly $13 billion in Medicare savings and deficit reduction. However, these savings have come with a price. Hospitals have closed and many more may go into bankruptcy if financial constraints are not eased. In Pennsylvania, preliminary survey findings are also showing that at least 31 percent of our hospitals are experiencing net operating losses.

I believe that we need to be especially sensitive to the increasing cost of Medicare for the beneficiary. In the last two years alone, the beneficiary's Part B premium has increased 56 percent, from $17.90 to $27.90 a month. That's before the $4.00 catastrophic premium is added to the equation.

This is the environment if the President is asking for another $5 billion in Medicare cuts. Whether we are looking at $5 billion or something below that figure, we face difficult budgetary decisions this year that are of great consequence to beneficiaries in the near and long-term.

Mr. Chairman, in order to eliminate the deficit we will have to work closely with the administration, or we will fail. I look forward to hearing the administration's views, which is just the first step in this process.

Prepared Statement of Senator Moynihan

Mr. Chairman: I welcome both Mr. Darman and Mr. Coleman.

Just two weeks ago, on February 23, 1989, as our distinguished witnesses know, this committee favorably reported out the nomination of Dr. Louis Sullivan to be Secretary of the Department of Health and Human Services. On March 1, 1989, the full Senate voted to confirm Dr. Sullivan as Secretary.

In the course of our deliberations, several of us questioned Dr. Sullivan closely about an issue of critical importance to this committee—that of the capped entitlement funding for the new JOBS program.

The JOBS program, enacted into law on October 13, 1988, as part of the Family Support Act, establishes a new education, training, and work-experience program for recipients of the Aid to Families with Dependent Children (AFDC) program.

Perhaps the most important feature of the new JOBS program is its capped entitlement funding. In FY 90, the statute specifies a maximum JOBS entitlement of $800 million. The cap rises to $1.3 billion by FY 95. States are to be guaranteed their share of these Federal funds, subject to these caps.

This committee, the Senate, the House, and the President all agreed, last year, that we would take this momentous step. Entitlement funding—capped entitlements to be sure, but entitlements nonetheless—represents a radical departure from prior practice. Neither the Congress nor, I presume, President Reagan, agreed to this new provision lightly.

Not three months after signing the Family Support Act into law, President Reagan sent us, on January 9, 1989, his budget proposal for FY 90. In it, he proposed reducing the maximum entitlement for the JOBS program to $350 million, down from the $800 million our new statute specifies. On February 9, 1989, President Bush sent his FY 90 budget modifications to us. No mention was made of the JOBS program. Hence our close questioning of Dr. Sullivan who promised that he would clarify the JOBS funding question should he be confirmed.

The leadership of this committee is gravely concerned that the January 9th FY 90 budget proposal would effectively make the JOBS program a discretionary program subject to annual appropriations. We object emphatically to such a proposal.

We have communicated our concerns to both the Budget Committee and the Appropriations Committee.

I had the opportunity of speaking with our distinguished new Director of the Office of Management and Budget on February 27. In our telephone conversation, he agreed with me that the JOBS program is, by law, an entitlement program. To date, however, we have no formal, written statement from the new administration indicating its intention to honor our statutory commitment to provide states with their share of up to $800 million in entitlement funding for the JOBS program in FY 90. We look forward to having such a statement for the record today.

PREPARED STATEMENT OF ROBERT D. REISCHAUER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. Chairman, I am pleased to appear before the committee this morning to discuss the economic outlook and President Bush's budget recommendations. In February, the Congressional Budget Office (CBO) published *An Analysis of President Reagan's Budgetary Proposals for Fiscal Year 1990.* Because the Bush budget proposals are largely the same as those in the Reagan budget, most of the analysis in CBO's earlier report remains pertinent.

CBO finds that the administration has understated the deficits that would result from adopting its proposed policies. The size of this gap depends on the budgetary treatment of the proposed savings and loan Resolution Financing Corporation (REFCORP). The administration proposes that REFCORP be an off-budget, government-sponsored enterprise. CBO believes, however, that REFCORP has all the earmarks of a government entity and should be included in the budget totals.

The administration estimates that the Federal deficit would decline from $163 billion in 1989 to $91 billion in 1990. Including REFCORP in the budget, however, would increase the estimated 1990 deficit by $22 billion, as shown in Table 1. Incorporating CBO's assumptions of lower economic growth and higher interest rates would add another $9 billion to the deficit estimate. CBO also believes that the administration's use of technical estimating assumptions has understated the deficit by $8 billion. Taking into account all of these factors, CBO estimates that the 1990 deficit would be $131 billion if all of the administration's proposals were adopted.

One can make a good case, however, that the spending made possible by REFCORP borrowing can be distinguished from most government spending and should not be counted under the Balanced Budget Act. Excluding these expenditures for resolving the savings and loan crisis from the deficit calculations would be consistent with the way asset sales are already treated under the act. Excluding both asset sales and REFCORP, CBO estimates that President Bush's proposals would result in a 1990 deficit of $109 billion—only $9 billion above the Balanced Budget Act target of $100 billion.

CBO ECONOMIC ASSUMPTIONS

CBO estimates that the long-run growth rate of the economy's productive capacity is about 2½ percent a year. In the aftermath of a recession, when much capacity is unused, the economy can easily grow more rapidly than this trend. But when almost all of the economy's capacity is being used, as is the case after six years of expansion, such growth is not possible. If the economy were to continue growing at its recent rapid rate, inflation would probably increase. The Federal Reserve has therefore sought to slow economic growth to a pace that is sustainable over the long haul.

FORECAST FOR 1989 AND 1990

CBO's short-term economic forecast is shown in Table 2. The forecast assumes that the Federal Reserve will be successful in holding the economy's growth to a rate that will avoid a sharp increase in inflation, and that the 1990 deficit will be reduced to satisfy the Balanced Budget Act's requirements.

The growth rate of real gross national product, which was 2.7 percent in 1988, is expected to rise to 2.9 percent in 1989 and drop back to 2.2 percent in 1990. Excluding the farm sector, which was hard hit by last summer's drought, the growth rate declines from 3.5 percent in 1988 to 2.1 percent in 1989 and 2.2 percent in 1990. Unemployment should remain near its current level of about 5 percent. Net exports and business fixed investment are expected to be the major sources of economic expansion in the next two years. Because of the strength of the dollar in mid-1988 and early 1989, however, the rate of improvement in real net exports is likely to be slower in 1989 and 1990 than it was in 1988.

CBO projects that increases in the prices of food and imports will push up consumer price inflation from 4.3 percent in 1988 to 5.0 percent in 1989. Because wage growth is likely to accelerate, inflation is not expected to subside much in 1990. Interest rates are projected to remain high in the first half of 1989, as monetary restraint continues. Rates are forecast to ease somewhat later in 1989 and in 1990, reflecting the expectation that the central bank will be successful in its effort to hold growth within the 2 percent to 2 ½ percent range.

UNCERTAINTY IN THE FORECAST

CBO's short-run forecast represents only one of the possible paths that the economy might take over the next two years. We believe, however, that the forecast lies roughly in the middle of the possible outcomes and is a prudent guide to budgetary planning. It is also close to the average of the 50 private-sector forecasts summarized in the *Blue Chip Economic Indicators*, as shown in Table 2.

Most forecasters agree that the Federal Reserve's effort to control inflation is the key source of uncertainty in the economy today. Even under the best of circumstances, it is difficult for monetary policy to slow the economy gradually. The economy may continue to grow rapidly in spite of monetary tightening, thereby provoking higher inflation, further tightening, a rapid increase in interest rates, and eventually a recession. Today, the Federal Reserve's task is also complicated by the volatility of the dollar, the shaky condition of a number of thrift institutions and banks, the debt problems of developing countries, and the high degree of corporate financial leveraging. Although CBO forecasts a smooth slowing of growth through 1989, a number of private forecasters expect a recession to begin this year.

The Bush administration's forecast is considerably more optimistic than CBO on the outlook for inflation and economic growth. The administration forecasts fourth-quarter-to-fourth-quarter growth rates that exceed CBO's by 0.6 percentage point in 1989 and 1.2 percentage points in 1990 (see Table 2). Inflation is more than a percentage point lower than CBO projects. Interest rates are about one-half of a percentage point lower in 1989 and about one and one-half percentage points lower in 1990. This more favorable outlook assumes that the potential for noninflationary growth is greater than estimated by CBO. The administration projects that productivity will grow about 2 percent a year. While this is near the post-World War II average, the growth of productivity since mid-1981 has been only 1.4 percent a year. The CBO forecast assumes that growth of productivity will continue at the slower recent rate.

PROJECTIONS FOR 1991 THROUGH 1993

For 1991 through 1993, CBO's economic assumptions are not a forecast of future conditions but are projections based on past trends. As shown in Table 3, CBO projects that real GNP will grow at an average annual rate of 2.2 percent, and that the unemployment rate will remain close to current levels. Consumer price inflation is projected to decline moderately after 1990 and stabilize around 4 percent. Interest rates are projected to decline throughout the period until they reach levels near the average of inflation-adjusted interest rates since 1973. In 1993, the three-month Treasury bill rate is assumed to be 6.1 percent, and the ten-year government note rate is projected to be 7.7 percent.

The administration's long-run assumptions, on the other hand, are substantially more optimistic than seems likely based on recent experience. The administration assumes that unemployment during the 1991-1993 period will remain at 5 percent and that the economy will achieve an average growth rate of 3.2 percent a year. The administration projects that inflation will fall to 2.2 percent in 1993, even though the economy is assumed to grow rapidly. Short-term interest rates are projected to drop to 3.5 percent in 1993 and long- term rates to 4.5 percent.

CBO BUDGET ESTIMATES

CBO's estimates of the deficit, assuming that REFCORP is treated as an on-budget entity, exceed the administration's figures by $40 billion in 1990 and increasing amounts in later years. In 1990, $22 billion of the $40 billion in reestimates is attributable to REFCORP. In 1991 through 1993, most of the reestimates are economic.

EFFECTS OF ECONOMIC ASSUMPTIONS

The differences between CBO's economic assumptions and those of the administration lead to substantially different budget estimates, primarily on the outlay side. The combination of lower real growth and higher inflation in CBO's assumptions produces nominal incomes and tax receipts close to the administration's. Despite lower nominal GNP projections, CBO projects slightly higher tax receipts in 1988 and 1989 than does the administration; projected receipts are higher because CBO assumes more income in the form of wages and salaries and capital gains. CBO projects, however, somewhat lower tax receipts than the administration in 1991 through 1993, largely because of a smaller corporate income-tax base.

CBO s economic assumptions increase outlays by $13 billion in 1990 and $72 billion in 1993, as shown in Table 4. CBO's projection of higher inflation leads to higher outlays for Federal retirement programs, Medicare and Medicaid, and other benefit programs. CBO's higher interest rates increase the cost of Federal borrowing. Finally, economic reestimates of revenues and outlays increase debt service costs. In total, CBO's economic assumptions increase the estimated deficit by $9 billion in 1990, growing to $78 billion in 1993.

EFFECTS OF TECHNICAL ESTIMATING ASSUMPTIONS

CBO's technical reestimates of the Bush budget increase the estimated 1990 deficit by $8 billion, the result of $11 billion in higher outlays offset by $3 billion in higher revenues (see Table 5). CBO expects that the 1990 proceeds from the administration's proposals to sell oil and gas leases in the Arctic National Wildlife Refuge and to accept competitive bids for use of the unassigned radio spectrum will be $4 billion less than the administration assumes. CBO's estimates of spending for defense and for the Federal Deposit Insurance Corporation are also higher by $4 billion and $3 billion, respectively.

After 1990, technical estimating differences between CBO and the administration average $20 billion a year. Almost half of this disparity stems from differing estimates of the administration's capital gains proposal. The administration contends that reducing the tax rate on capital gains will permanently increase realizations of gains by enough to offset the revenue loss from the lower rate. CBO and the Joint committee on Taxation (JCT) judge that, after an initial surge in 1990, the increase in realizations will not be sufficient to offset the rate reduction. While the administration estimates that its capital gains proposal would raise revenues by $5 billion in 1991, CBO and JCT estimate a revenue loss of $4 billion. Similar estimating differences prevail in 1992 and 1993.

THE SAVINGS AND LOAN PROBLEM

The administration's plan to resolve the savings and loan crisis involves spending $205 billion over the 1989-1999 period. Of this amount, $136 billion would be for resolving insolvent thrift institutions, administering the program, and paying off Federal Savings and Loan Insurance Corporation (FSLIC) notes. The remaining $69 billion would be paid to service the debt incurred in financing the plan.

The bulk of the needed cash would be raised through borrowing. A new entity, the Resolution Financing Corporation, would borrow $50 billion in private credit markets in 1989 through 1991 to help finance near-term resolutions. The existing Financing Corporation would raise $7 billion, and the Treasury would borrow $84 billion. Liquidation proceeds, the Federal Home Loan Banks, savings and loan assessments, and other FSLIC income would provide the remaining $64 billion.

The administration proposes that REFCORP be treated as an off-budget entity. In CBO's view, however, REFCORP would not truly be privately owned and should be included in the budget. Moreover, we believe that the Treasury should do all borrowing, which would be less costly and quicker than borrowing through a new funding agency.

Spending the $50 billion in borrowed funds, however, would have virtually no macroeconomic impact. Thus, one can make a good case for excluding such spending from Balanced Budget Act calculations in the same manner as asset sales and loan prepayments are now excluded. Excluding spending from Balanced Budget Act calculations may set unfortunate precedents, but so does creating off-budget entities to perform governmental functions. Ultimately, the appropriate budgetary treatment for financing a solution to the savings and loan problem is a policy matter that should be settled by the Congress and the President.

THE ADMINISTRATION'S BUDGET PROGRAM

The Bush administration's budget program divides the spending side of the budget into two categories. For most of the budget—just over $1 trillion in 1990—the administration makes specific spending proposals. Another $136 billion in spending, however, is subject to what the administration refers to as a flexible freeze. The administration proposes that total outlays for this residual category be held to their 1989 level and that decisions about spending for specific residual programs be determined through negotiations involving the Congress and the administration. In the meantime, however, the Office of Management and Budget has told the agencies that "the Reagan budget proposals within the residual category are to be treated as if they were the Bush administration proposals for purposes of starting the budget process with the Congress."

CBO's analysis of the Bush proposals follows the same format. For programs where the administration has made specific proposals, we have priced them out. For the residual programs, we have taken the Bush administration's figure of $136 billion as a target. The Reagan administration's proposals for these same programs, however, would have resulted in spending of $138 billion in 1990. Thus, just over $2 billion in unspecified spending reductions beyond those contained in the Reagan budget would be required to reach President Bush's target.

CBO's baseline budget projections provide a benchmark against which one can measure the administration's budget program. The baseline projects the course of the budget on the assumption that current taxing and spending policies continue unchanged. It generally assumes that tax and entitlement laws now on the statute books will continue. National defense and nondefense discretionary appropriations are assumed to keep pace with inflation. Because the baseline and the CBO estimate of the budget employ the same economic and technical estimating assumptions, differences between the two are solely the result of proposed policy changes. CBO estimates that the Bush administration's budget proposals would reduce the deficit by $15 billion in 1990 and $38 billion in 1993, as shown in Table 6.

REVENUES

Compared with the CBO baseline, the Bush administration's revenue proposals would reduce the deficit by $4 billion in 1990 but would increase it slightly thereafter, as shown in Table 7. This pattern follows that of the proposed reduction in the capital gains tax rate, which CBO and JCT estimate would increase revenues by $3.3 billion in 1990 and reduce tax collections in 1991 through 1993. In addition to the capital gains proposal, the Bush administration has proposed the establishment of enterprise zones, extension of the excise tax on telephone use, a child care credit, and additional incentives for oil and gas exploration. Otherwise, President Bush has endorsed the tax proposals contained in the Reagan budget, including extension of Medicare taxes and coverage to all employees of State and local governments, maintenance of airport and airway taxes at 1989 rates, increased Internal Revenue Service funding to enforce tax laws, and inducements for research and experimentation.

NATIONAL DEFENSE

President Bush's defense request is intended to provide a constant level of real budget authority for the military activities of the Department of Defense in 1990. It would provide real increases of 1 percent in 1991 and 1992 and 2 percent in 1993, using the administration's economic assumptions. It would provide little if any real growth, however, under CBO's higher inflation assumptions. The administration also proposes more spending to clean up and modernize nuclear weapons facilities. While details of the defense program are not yet available, CBO estimates that it would increase outlays slightly in 1990 compared with the baseline and reduce them in later years.

ENTITLEMENTS AND OFFSETTING RECEIPTS

The Bush administration's budget for 1990 proposes policies that would raise entitlement spending relative to CBO's baseline by $0.8 billion in 1990 and reduce it by $17.4 billion in 1993, as shown in Table 8. The Bush administration's proposals for spending on entitlements and other mandatory programs differ from the Reagan budget in three major respects. First, the administration would substantially increase spending to resolve the savings and loan crisis, as previously described. Second, President Bush proposes no specific reductions in Medicaid or other means-tested benefits. Third, he recommends a new tax credit for each child under age four in low-income working families. The refundable portion of the credit would be recorded as a budget outlay, like the existing Earned Income Tax Credit.

President Bush's budget assumes Medicare and farm price support savings of the same size as recommended in the Reagan budget, although the administration has not endorsed the specific mechanisms the Reagan budget proposed for achieving those savings. President Bush adopts the Reagan proposals to reduce cost of living adjustments for Federal civilian and military retirees, eliminate the lump-sum payment option in the Civil Service Retirement System, and reduce spending on health benefits for annuitants. The President proposes to continue the 1 percent origination fee currently charged to veterans on federally guaranteed housing loans; the Reagan administration had proposed to raise the fee to 3.8 percent.

The Federal government collects over $60 billion a year in user fees and other receipts that are counted as offsets to spending. The Bush administration proposes several changes—all included in the Reagan budget—that would increase offsetting receipts by $0.6 billion in 1990 and $4.6 billion in 1993. The budget would extend the provision requiring that the Supplementary Medical Insurance premium be large enough to finance 25 percent of the program's costs. Raising the premium would bring in $0.2 billion in 1990 and $2.2 billion in 1993, as Table 9 shows. The budget also proposes fees for the right to produce or import chlorofluorocarbons, the use of certain bands of the radio spectrum, and the issuance of securities by government-sponsored enterprises. In addition, leases would be sold for oil and gas production in the Arctic National Wildlife Refuge.

OTHER SPENDING

The Bush administration makes specific proposals for about 40 percent of nondefense discretionary spending. Increases over baseline levels are requested in 1990 for international affairs, science and space, the decennial census, Federal Aviation Administration and Coast Guard operations, certain education initiatives, health research, and drug control and enforcement. The administration proposes to reduce spending by eliminating direct loans by the Farmers Some administration and Rural Electrification Administration and replacing them in part by guaranteed loans and vouchers. On balance, outlays for enumerated discretionary programs would be $1 billion higher than the CBO baseline in 1990.

Over $9 billion of the $15 billion reduction in the 1990 deficit would come out of the residual programs, for which President Bush has made no specific proposals. The residual category consists almost entirely of programs within the spending jurisdiction of the Appropriations Committee, although some of these are mandatory programs, such as payments to the States for foster care and the administrative expenses of food stamps and family support. In addition, the residual category contains a number of offsetting receipts and permanent appropriations, notably the Postal Service fund. The $2 billion in unspecified savings needed to hold residual programs to $136 billion in outlays arises primarily because the outlays of the Postal Service will grow by about $2 billion from 1989 to 1990.

The Bush administration continues the Reagan administration's policy of privatizing Federal commercial activities by selling certain Federal assets. Major proposals include the sale of rural and other housing loans, the prepayment of Rural Electrification administration loans, the sale of the Naval Petroleum Reserves, and the sale of the Southeastern and Alaska Power Administrations. Proceeds from these sales, however, may not be counted toward meeting the Balanced Budget Act targets.

As this committee knows, President Bush's budget proposals have not been presented in the usual detail, and further information about them emerges each day. We will inform the committee staff promptly if any of this new information causes a significant change in our conclusions. We look forward to assisting you in your work on the 1990 budget.

TABLE 1. CBO AND ADMINISTRATION ESTIMATES OF THE BUDGET DEFICIT UNDER BUSH ADMINISTRATION POLICIES (By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993
Administration Estimate, Including Asset Sales	163	91	62	27	-4
CBO Reestimates					
Economic differences	-4	9	33	55	78
Technical differences	-2	8	17	22	22
REFCORP[a]	9	22	12	b	b
Subtotal	3	40	62	77	100
CBO Estimate, Including Asset Sales and REFCORP	166	131	124	104	97
Adjustments					
Asset sales	5	3	2	1	-1
REFCORP	-10	-25	-15	0	0
Subtotal	-5	-22	-13	1	-1
CBO Estimate, Excluding Asset Sales and REFCORP	161	109	111	105	96
Balanced Budget Act Targets	136	100	64	28	0

SOURCES: Office of Management and Budget; Congressional Budget Office.

NOTE: The totals include Social Security, which is off-budget.

a. The proposed Resolution Financing Corporation (REFCORP) would borrow money in private credit markets to assist in resolving troubled savings and loan institutions.

b. Less than $0.5 billion.

TABLE 2. COMPARISON OF ADMINISTRATION, CBO, AND *BLUE CHIP* SHORT-RUN ECONOMIC FORECASTS

	Actual	Forecast	
	1988	1989	1990
Fourth Quarter to Fourth Quarter (Percent change)			
Real GNP			
Administration	2.6	3.5	3.4
CBO	2.6	2.9	2.2
Blue Chip	2.7	2.4	1.8
Nominal GNP			
Administration	6.8	7.3	7.0
CBO	6.7	6.9	6.6
Blue Chip	6.9	6.8	6.2
Consumer Price Index[a]			
Administration	4.2	3.6	3.5
CBO	4.3	5.0	4.8
Blue Chip	4.2	4.7	4.7
Calendar Year Averages (Percent)			
Three-Month Treasury Bill Rate			
Administration	6.7	7.4	5.5
CBO	6.7	7.9	7.1
Blue Chip	6.7	8.1	7.5
Ten-Year Government Bond Rate			
Administration	8.9	8.6	7.2
CBO	8.9	9.3	9.0
Blue Chip[b]	8.9	8.9	8.5
Civilian Unemployment Rate			
Administration[c]	5.4	5.2	5.1
CBO	5.5	5.5	5.5
Blue Chip[b]	5.5	5.4	5.6

SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (February 10, 1989).

a. Consumer Price Index for urban wage earners and clerical workers.

b. *Blue Chip* does not project a ten-year note rate. The values shown here are based on the *Blue Chip* projection of the AAA bond rate, adjusted by CBO to reflect the estimates spread between AAA bonds and ten-year government notes.

c. The Administration's projection is for the total labor force, including armed forces residing in the United States, while the CBO and *Blue Chip* projections are for the civilian labor force excluding armed forces. In recent years, the unemployment rate for the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force alone.

TABLE 3. COMPARISON OF ADMINISTRATION AND CBO ECONOMIC ASSUMPTIONS, 1989-1993 (By calendar year)

	Actual	Forecast		Projected		
Variable	1988	1989	1990	1991	1992	1993
Nominal GNP (Billions of dollars)						
Administration	4,860	5,219	5,577	5,947	6,304	6,648
CBO	4,859	5,209	5,542	5,902	6,281	6,685
Real GNP (Percent change, year over year)						
Administration	3.8	3.3	3.2	3.3	3.2	3.2
CBO	3.8	2.9	2.1	2.2	2.2	2.3
Consumer Price Index[a] (Percent change, year over year)						
Administration	4.0	3.8	3.7	3.2	2.7	2.2
CBO	4.0	4.9	4.9	4.6	4.4	4.4
GNP Deflator (Percent change, year over year)						
Administration	3.4	4.0	3.6	3.2	2.7	2.2
CBO	3.4	4.2	4.2	4.2	4.1	4.1
Three-Month Treasury Bill Rate (Percent)						
Administration	6.7	7.4	5.5	4.5	4.0	3.5
CBO	6.7	7.9	7.1	6.7	6.4	6.1
Ten-Year Government Bond Rate (Percent)						
Administration	8.9	8.6	7.2	6.0	5.0	4.5
CBO	8.9	9.3	9.0	8.6	8.1	7.7
Civilian Unemployment Rate						
Administration[b]	5.4	5.2	5.1	5.0	5.0	5.0
CBO	5.5	5.5	5.5	5.5	5.6	5.6
Tax Bases						
Wage and salary disbursements						
Administration	2,436	2,609	2,783	2,973	3,163	3,347
CBO	2,435	2,615	2,787	2,969	3,163	3,370
Other personal income[c]						
Administration	1,625	1,724	1,856	1,958	2,045	2,121
CBO	1,626	1,754	1,870	1,977	2,090	2,211
Corporate Profits[d]						
Administration	302	352	399	442	475	499
CBO	299	328	351	378	390	401

SOURCES: Congressional Budget Office; Office of Management and Budget.

a. Consumer Price Index for urban wage and clerical workers.

b. The Administration's projection is for the total labor force, including armed forces residing in the United States, while the CBO projection is for the civilian labor force excluding armed forces. In recent years, the unemployment rate for the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force alone.

c. *Other personal income* is personal income less wage and salary disbursements.

d. Corporate profits reported are book, not economic, profits.

TABLE 4. EFFECTS OF CBO ECONOMIC ASSUMPTIONS ON ESTIMATES OF THE ADMINISTRATION'S BUDGET (By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993
Revenues	5	4	-1	-3	-7
Outlays					
Benefit programs	a	4	9	15	24
Net interest					
As a result of interest rates	1	9	21	31	38
Debt service	a	a	2	5	10
Total Outlays	1	13	32	51	72
Deficit	-4	9	33	55	78

TABLE 5. EFFECTS OF CBO TECHNICAL ASSUMPTIONS ON ESTIMATES OF THE ADMINISTRATION'S BUDGET (By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993
Revenues					
Current law	-1	5	3	2	7
Capital gains tax reduction	0	-2	-9	-10	-9
Other proposals	a	a	-1	-1	-1
Total Revenues	-1	3	-7	-9	-2
Outlays					
National defense	-2	4	4	4	4
Leasing of Arctic National Wildlife Refuge	0	2	-2	0	a
Farm price supports	-1	-1	-1	-1	-1
FDIC	a	3	3	4	4
Medicaid and Medicare	a	1	1	-1	2
Income security	a	2	3	3	4
Social Security	a	a	-1	-2	-3
Net interest	-1	-1	2	4	6
Federal Communications Commission auction receipts	0	2	1	0	0
Proposed asset sales	0	a	a	2	2
Other outlays	-1	-1	a	1	2
Total Outlays	-3	11	10	13	19
Deficit	-2	8	17	22	22

SOURCE: Congressional Budget Office.

NOTE: The totals include Social Security, which is off-budget.

a. Less than $0.5 billion.

TABLE 6. THE BUSH ADMINISTRATION'S BUDGET PROGRAM AS ESTIMATED BY CBO (By fiscal year, in billions of dollars)

	1990	1991	1992	1993
CBO Baseline Deficit	146	146	140	135
Proposed Changes				
Revenues[a]	-4	b	2	3
National defense	1	-2	-5	-6
Nondefense discretionary spending	1	2	3	3
Entitlements and other mandatory spending	1	-6	-16	-17
Offsetting receipts	-1	-5	-3	-5
Asset sales and prepayments	-3	-2	-1	1
Net interest	-1	-3	-5	-7
Residual programs	-9	-6	-10	-10
Total Proposed Changes	-15	-22	-35	-38
Deficit, Bush Administration Budget as Estimated by CBO[c]	131	124	104	97

SOURCE: Congressional Budget Office.

NOTE: The totals include Social Security, which is off-budget.

a. Revenue increases are shown with a negative sign because they reduce the deficit.

b. Less than $0.5 billion.

c. Including asset sales and REFCORP.

TABLE 7. THE BUSH ADMINISTRATION'S PROPOSALS--REVENUES
(By fiscal year, in billions of dollars)

	1990	1991	1992	1993
CBO Baseline	1,068.6	1,140.2	1,208.7	1,280.5
Proposed Changes				
Reduce capital gains tax rate	3.3	-4.0	-6.4	-6.9
Establish enterprise zones	-0.2	-0.2	-0.3	-0.4
Increase incentives for oil and gas exploration	-0.3	-0.4	-0.4	-0.5
Extend telephone excise tax	–	1.6	2.7	2.9
Extend research and experimentation provisions	-2.1	-1.4	-1.8	-2.0
Extend Medicare coverage to all state and local employees	1.7	1.9	1.9	1.9
Increase IRS enforcement	0.3	0.6	0.7	0.7
Repeal reduction in airport and airway taxes	0.9	1.5	1.6	1.8
Other	a	-0.1	-0.1	-0.4
Total Proposed Changes	3.7	-0.4	-2.1	-2.9
Bush Administration's Budget, as Estimated by CBO	1,072.3	1,139.7	1,206.6	1,277.6

SOURCES: Office of Management and Budget; Congressional Budget Office.

NOTE: The totals include Social Security, which is off-budget.

a. Less than $50 million.

TABLE 8. THE BUSH ADMINISTRATION'S PROPOSALS-- ENTITLEMENTS AND OTHER MANDATORY SPENDING
(By fiscal year, in billions of dollars)

	1990	1991	1992	1993
CBO Baseline	585.3	633.0	673.1	719.6
Proposed Changes				
Deposit insurance	12.8	6.8	-1.8	-1.0
Child care credit	0.3	3.0	3.3	3.6
Medicare	-4.8	-6.4	-7.9	-9.1
Federal retiree benefits				
Civilian retirement	-2.7	-3.4	-3.7	-4.1
Military retirement	-0.8	-1.2	-1.5	-1.8
Annuitants' health benefits	-1.0	-1.2	-1.3	-1.5
Subtotal	-4.4	-5.8	-6.6	-7.4
Federal price supports	-1.6	-1.7	-1.4	-1.1
Veterans' loans	-0.7	-0.7	-0.8	-0.8
Other	-0.7	-1.0	-1.5	-1.7
Total Proposed Changes	0.8	-5.8	-16.6	-17.4
Bush Administration's Budget as Estimated by CBO[a]	586.1	627.2	656.5	702.2

SOURCE: Congressional Budget Office.

NOTE: The totals include Social Security, which is off-budget.

a. The figures do not include possible changes to residual programs.

TABLE 9. THE BUSH ADMINISTRATION'S PROPOSALS--OFFSETTING RECEIPTS (By fiscal year, in billions of dollars)

	1990	1991	1992	1993
CBO Baseline	-61.4	-64.2	-68.2	-71.8
Proposed Changes				
Medicare	-0.2	-0.7	-1.3	-2.2
Chlorofluorocarbons production rights	-0.4	-1.4	-0.6	-0.6
Unassigned spectrum auction	-0.3	-0.3	0	0
Government enterprises	-0.1	-0.2	-0.6	-0.8
Arctic National Wildlife Refuge	0	-1.6	a	-1.0
Power marketing reforms[b]	-0.0	-0.4	-0.3	-0.4
Other	0.3	-0.3	-0.1	0.3
Total Proposed Changes	-0.6	-4.8	-2.8	-4.6
Bush Administration's Budget as Estimated by CBO[c]	-62.0	-69.0	-71.0	-76.4

SOURCE: Congressional Budget Office.

NOTE: The totals include Social Security, which is off-budget.

a. Less than $50 million.

b. Portions of the proposed power marketing reforms are included in the category of "Entitlements and Other Mandatory Spending."

c. The figures do not include possible changes to residual programs.

PREPARED STATEMENT OF SENATOR ROCKEFELLER

Thank you Chairman Bentsen for holding this important hearing this morning.

Like so many of our colleagues, I have many questions and concerns about President Bush's budget proposal. I had hoped it would be easier to understand how his proposal will both reduce the deficit to $100 billion and fulfill his commitments regarding taxes and certain program expansions.

But almost nothing is easy around here. My hope, however, is that today's hearings and the others planned by the Chairman for next week will shed some light on crucial aspects of the President's budget plan and provide some constructive information and guidance to all the parties involved in the budget process ahead.

Though many parts of the President's budget plan seem to be very murky, his proposal to cut the Medicare program by $5 billion is as plain as can be. In my view, it also is a disturbing and unacceptable proposal. It targets this vital health care program for bearing too much of the burden of deficit reduction.

As we all know, Medicare has had to contribute substantial savings and cuts over the past 8 years. Congress has tried to protect beneficiaries from any harm, but the cuts have taken their toll. When hospital payments, for example, don't keep pace with inflation, the hospitals suffer. In my State of West Virginia, five hospitals have closed recently, and many more are on the brink of closing. They believe inadequate funding from Medicare is a major reason for their severe financial problems.

Medicare "cuts" to balance the budget ultimately affect senior citizens and the care they receive. I am deeply worried that senior citizens cannot afford to pay more for their health care. From 1980 to 1987, out-of-pocket health care costs rose by 49 percent.

Last Friday, in the Medicare and Long-Term Subcommittee, which I now chair, we heard from top experts in the health care field. I know it will not be easy to fill in the gaps in our health care system, hold down costs, and make sure seniors are receiving quality care. The problems are complex and the solutions costly.

I am afraid that we cannot afford another 4 years when the budget process drives decisions about Medicare. Medicare policy should not be set with regard only to deficit targets, and instead should be developed within a framework of the goals of the program and the best interests of our elderly and disabled citizens.

I have focused my remarks this morning on the Medicare portion of the President's budget. I should briefly note that I also have concerns about the administration's views on the Trade Adjustment Assistance Program, on the new programs and services established by the historic welfare reform effort we enacted into law last fall, and on Medicaid and its role in reducing infant mortality and improving the health of low-income families.

I welcome this chance to hear from the OMB Director, Richard Darman. I hope he will listen to us carefully and with an open mind, too, and take back to the President our concerns. I applaud President Bush's pledge to undertake the task of creating a budget for 1990 in a collaborative, constructive manner. I am confident that the President, his Cabinet, and Mr. Darman will be willing to revisit key issues, most particularly the notion which I reject—of cutting $5 billion from Medicare.

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